

SUNSET ADVISORY COMMISSION

STAFF REPORT

*Railroad Commission
of Texas*

NOVEMBER 2012



Sunset Advisory Commission

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Cover photo: The Texas Capitol is a marvel of craftsmanship down to the smallest details. The beautifully carved wood door frames are emphasized with elaborate, custom-designed bronze hinges and hardware produced especially for the building by Sargent and Co. of New Haven, Connecticut, in the late 1880s. The eight inch by eight inch hinges are inscribed with the words "Texas Capitol", decorated with incised designs of geometric and stylized floral motifs, and weigh over seven pounds each.

RAILROAD COMMISSION OF TEXAS

SUNSET STAFF REPORT

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SUMMARY

SUMMARY

Despite its misleading name, the Railroad Commission of Texas (Commission) regulates the state's oil and gas industry and has nothing to do with railroads. The clarity of its name matters now more than ever as the Commission's job takes center stage in overseeing an unprecedented expansion of oil and natural gas drilling in the state. Two years ago Texas experienced a huge growth of gas drilling in the Barnett Shale, with oil and gas production bumping up against urban and suburban areas of the state for the first time. Now, drilling in the Eagle Ford Shale is transforming parts of South Texas into one of the fastest developing oil fields in the world.

While clearly a boon for Texas' economy, questions have been raised about the impact and safety of new drilling technologies that have made previously irretrievable oil and natural gas much more accessible. Will the prolific growth of drilling and pipelines in new areas of the state be safe? Will increased production pollute the surrounding groundwater? What impact will the influx of trucks and drilling have on local roads and infrastructure? Answering these questions and managing these changes requires a strong and effective regulatory agency that is proactive in educating the public, sets clear and predictable rules for the industry, and fairly and objectively ensures these rules are followed. With these challenges in mind, Sunset staff focused on changes to help improve the Railroad Commission's transparency, leadership, funding, enforcement, and safety.

Besides having a name sure to confuse people impacted by expanded drilling, voters may not understand the duties of the three statewide elected Commissioners running for these offices. With campaigns requiring millions of dollars and an increasing majority of these funds coming from the regulated community, the public needs assurance that the Commission's regulatory decisions are made in the public's interest. The recommendations in Issue 1 aim to address these concerns by changing the agency's name, limiting when contributions can be solicited, and requiring certain contested cases to be heard by independent hearing examiners outside the agency.

Beyond transparency and accountability, having an adequately funded regulatory agency with sufficient staff and up-to-date computer systems to keep pace with a growing industry is essential. The 82nd Legislature enacted key Sunset changes from 2011 that have enabled the Commission to largely self-fund its Oil and Gas program. However, the Oil and Gas Regulation and Cleanup Fund has outgrown its \$20 million cap, restricting the Commission's ability to adequately fund these operations. Another related concern is the Commission's inability to adequately fund its pipeline safety functions. Changes recommended in Issues 2 and 3 would eliminate the \$20 million cap

With the recent boom in production, having a transparent and objective regulator is more important than ever.

on the oil and gas fund and authorize a pipeline permit fee to help pay for oversight of Texas' rapidly growing network of oil and gas pipelines.

Concerns about inadequate enforcement efforts, raised in 2011 by the Sunset Commission, led to Railroad Commission initiatives to beef up its enforcement processes. The Commission has adopted new penalty guidelines that assign higher penalties for repeat violations, and has developed and is field-testing a new policy to help ensure more serious violations result in enforcement action, not simply compliance. No clear-cut impact of these changes could be measured as these changes have just recently begun. Thus, to ensure these enforcement efforts continue, recommendations in Issue 4 would place these requirements into statute.

The remaining issues recommend changes previously adopted by the Sunset Commission in 2011 that were not enacted by the Legislature. These issues address the promotion of propane, damage prevention for interstate pipelines, and the pooling of mineral rights. Appendix A summarizes the recommendations adopted by the Sunset Commission in January 2011 and their current status. Additional information on the previous review can also be found on the Sunset Commission's website.

The following material summarizes the key recommendations in this report and the overall fiscal impact of these changes.

Issues and Recommendations

Issue 1

Changing the Railroad Commission's Name and Addressing the Appearance of Conflicts of Interest Remain Critical to Ensuring Transparent and Effective Regulation.

Key Recommendations

- Change the name of the Railroad Commission of Texas to the Texas Energy Resources Commission and continue the agency for 10 years.
- Limit the solicitation and receipt of campaign contributions by a Commissioner or any candidates seeking the office to a year and a half timeframe around the election, rather than throughout the full six-year term.
- Prohibit a Commissioner from knowingly accepting contributions from a party with a contested case before the Commission.
- Require the automatic resignation of a Commissioner that announces or becomes a candidate for another elected office.
- Require the Commission to adopt a recusal policy in rule, including a requirement to explain the reason for any recusal from a decision in writing.
- Require the Commission to use the State Office of Administrative Hearings to conduct independent hearings for its contested gas utility and enforcement cases.

Issue 2

Self-Funding of the Oil and Gas Program Is Working Well, But Would Benefit From Removal of the \$20 Million Cap on the Oil and Gas Regulation and Cleanup Fund.

Key Recommendations

- Eliminate the cap on the Oil and Gas Regulation and Cleanup Fund.
- Abolish the Oil Field Cleanup Fund Advisory Committee.

Issue 3

The Commission's Current Pipeline Safety Fee Does Not Cover the Program's Costs, Limiting the Agency's Ability to Ensure Public Safety Within a Growing Oil and Gas Industry.

Key Recommendations

- Authorize the Commission to create a pipeline permit fee to help support its Pipeline Safety program.
- Add language in the General Appropriations Act to further ensure that the Commission collects fee amounts to offset the costs of administering its Pipeline Safety program, including administration costs and benefits.

Issue 4

While Changes Have Begun, the Commission Continues to Need Statutory Direction to Improve Its Enforcement Processes.

Key Recommendations

- Require the Commission to develop an enforcement policy to guide staff in evaluating and ranking oil- and natural gas-related violations.
- Require the Commission to formally adopt penalty guidelines.

Issue 5

The Commission's Promotion of Propane Is No Longer Necessary.

Key Recommendation

- Eliminate the Commission's statutory authority to promote the use of propane and to charge a delivery fee for this purpose.

Issue 6

Texas' Interstate Pipelines Lack Damage Prevention Oversight Needed to Ensure Public Protection.

Key Recommendation

- Authorize the Commission to enforce damage prevention requirements for interstate pipelines.

Issue 7

The Commission's Mineral Pooling and Field Spacing Hearings Lack Certain Procedural Safeguards for Mineral Owners.

Key Recommendations

- Authorize a party affected by forced pooling to request a hearing on the matter in the county where the proposed well will be drilled.
- Direct the Commission to develop a fee schedule for increased charges associated with re-filing previously withdrawn applications for forced pooling or field spacing exceptions.

Issue 8

The Railroad Commission's Key Reporting Requirement Continues to Serve a Useful Purpose.

Key Recommendation

- Continue requiring the Commission to submit its report on the Oil and Gas Regulation and Cleanup Fund to the Legislature.

Fiscal Implication Summary

This report contains recommendations that would have a net positive fiscal impact to the State of about \$450,000 based on an estimated savings of about \$1.5 million to the General Revenue Fund and an estimated revenue loss of about \$1.05 million to the Alternative Fuels Research and Education (AFRED) General Revenue dedicated account. The recommendations with a fiscal impact are summarized below, followed by a five-year summary chart showing the cumulative impact of the recommendations.

Issue 1 — Changing the agency's name would have no significant fiscal impact as the Commission would phase in these changes over time using existing resources. Requiring the use of the State Office of Administrative Hearings (SOAH) to conduct contested gas utility and enforcement hearings would have no net fiscal impact to the State as it would add four full-time equivalent positions to SOAH at a cost of about \$440,000 with corresponding reductions at the Commission.

Issue 3 — Authorizing a new pipeline permit fee would have a savings of \$1,499,779 to the General Revenue Fund. Revenue from the newly created pipeline permit fee would be used to offset the general revenue the Legislature currently appropriates to the Commission for its Pipeline Safety program.

Issue 4 — Requiring the Commission to develop an enforcement policy and penalty guidelines would likely generate additional revenue from penalties, which are deposited in the General Revenue Fund. However, the fiscal impact of these changes could not be estimated because penalty amounts generated would depend on the number and seriousness of future violations.

Issue 5 — Eliminating the Commission's propane promotion program would result in an estimated annual revenue loss of \$1,052,455 to the AFRED General Revenue dedicated account since current fee revenue greatly exceeds the actual costs of operating the program. This change would also eliminate four full-time equivalent positions.

Railroad Commission of Texas

Fiscal Year	Savings to the General Revenue Fund	Loss to the AFRED General Revenue Dedicated Account	Change in Number of FTEs From FY 2013
2014	\$1,499,779	\$1,052,455	-8
2015	\$1,499,779	\$1,052,455	-8
2016	\$1,499,779	\$1,052,455	-8
2017	\$1,499,779	\$1,052,455	-8
2018	\$1,499,779	\$1,052,455	-8

AGENCY AT A GLANCE

AGENCY AT A GLANCE

The Railroad Commission of Texas (Commission) serves as the State's primary regulator of the oil and gas industry. The Commission's mission is to ensure efficient production, safe transportation, and fair access to the state's energy resources, with minimal effects to the environment. To fulfill its mission, the Commission:

- oversees all aspects of oil and natural gas production, including permitting, monitoring, and inspecting oil and natural gas operations;
- permits, monitors, and inspects surface coal and uranium exploration, mining, and reclamation;
- inspects intrastate pipelines to ensure the safety of the public and the environment;
- oversees gas utility rates and ensures compliance with rates and tax regulations; and
- promotes the use of propane and licenses all propane distributors.

Key Facts

- **Commissioners.** The Commission consists of three statewide elected officials who serve staggered, six-year terms. The accompanying chart, *Railroad Commission of Texas*, details the current Commissioners and when their respective terms expire. Commissioners elect their chair, and the Governor appoints a new member if a vacancy on the Commission occurs. The Commission met 23 times in fiscal year 2012.

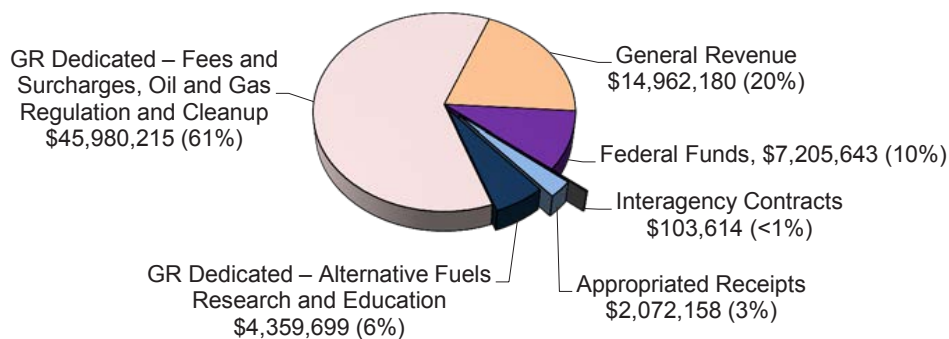
Railroad Commission of Texas

Commissioner	Term Expires
Barry T. Smitherman, Chair	2014
Buddy Garcia*	2012
David Porter	2016

* In January 2013 Commissioner-elect Christi Craddick will fill this position with a term expiring in 2018.

- **Staff.** The Commission employs 705 staff, 41 percent of whom operate out of the Commission's 11 field offices. Most field staff perform inspections of oil, natural gas, and pipeline facilities.
- **Funding.** During the 82nd Session, the Legislature changed the Commission's primary source of funding from General Revenue to fees and surcharges paid by the oil and gas industry to support the Commission's oil and gas regulatory operations, which include permitting, inspecting, and cleanup.¹ As a result of the Legislature changing the Commission's sources of funding, the Commission received an appropriation of \$74.7 million in fiscal year 2012, including about \$46 million in revenue from fees and surcharges and \$15 million in general revenue. The pie chart on the following page, *Railroad Commission Sources of Revenue*, details the Commission's sources of funding in fiscal year 2012.

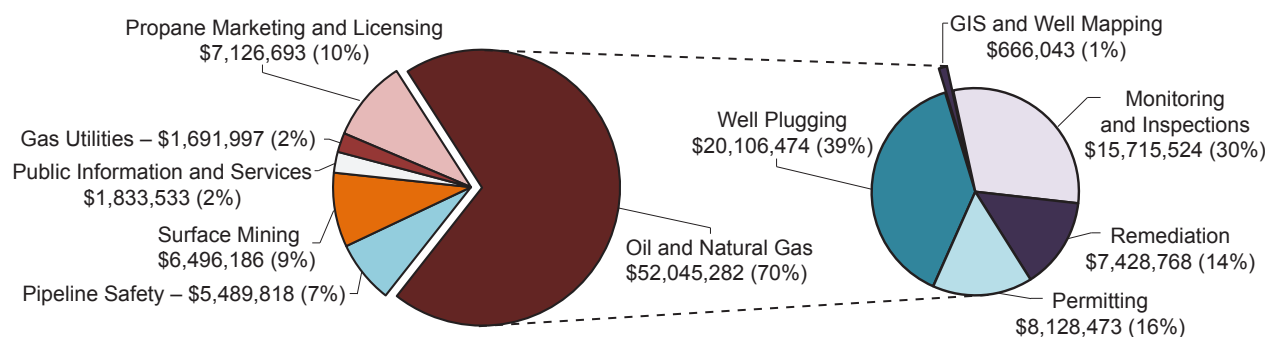
**Railroad Commission
Sources of Revenue
FY 2012**



Total: \$74,683,509

The pie chart, *Railroad Commission Expenditures by Program*, provides a breakdown of the Commission's \$74.7 million in expenditures in fiscal year 2012, with a more detailed breakout of the 70 percent of expenditures devoted to permitting, inspecting, and remediating oil and natural gas operations.

Railroad Commission Expenditures by Program – FY 2012



Total: \$74,683,509

- **Oil and natural gas production oversight.** The Commission oversees the exploration and production of oil and natural gas from drilling and producing to well plugging and remediation.

Permitting. Statute requires all operators involved in the exploration or production of oil and natural gas to provide the Commission with basic organizational information and adequate financial surety; ensure water quality and prevent production-related pollution; and prevent waste and protect the correlative rights of mineral owners. In fiscal year 2012, the Commission issued more than 28,900 drilling permits, up 56 percent from fiscal year 2009.

Compliance. The Commission monitors more than 398,000 oil and natural gas wells, more than 72 percent of which are actively producing. Field inspectors inspect oil and gas leases and respond to complaints and pollution violations. In cases of ongoing pollution or where an operator refuses to come into compliance with State regulations, the Commission has the authority to enter a lease

and shut off production. In fiscal year 2012, the Commission performed more than 118,000 oil and natural gas facility inspections, identified about 55,000 violations, issued about 9,000 severance orders, pursued more than 250 formal enforcement actions, and assessed \$1.9 million in penalties.

Well plugging and site remediation. In fiscal year 2012, the Commission plugged 764 orphaned wells and remediated 200 abandoned and polluted sites. An estimated 7,400 orphaned wells remain unplugged. Additionally, the Commission oversees pollution cleanups performed by the oil and gas industry — ensuring cleanups do not become State-managed projects — and provides incentives to landowners to remediate production-related pollution by granting landowners a release of liability in exchange for successful remediation. In fiscal year 2012, the Commission monitored 607 operator-initiated cleanup efforts and granted three landowners a release of liability for successfully remediating their property.

- **Pipeline safety.** To ensure the integrity of Texas' 170,000 miles of regulated intrastate pipeline, field staff conduct pipeline safety inspections; audit pipeline operators and their records; and investigate pipeline accidents. In fiscal year 2012, field staff conducted more than 3,300 pipeline safety inspections, identified approximately 2,700 violations, completed 16 enforcement actions, and collected about \$200,000 in penalties. The Commission also develops educational programs on pipeline safety for pipeline operators and excavators and enforces damage prevention rules, completing more than 3,800 enforcement actions, and collecting more than \$1.6 million in penalties for damage prevention violations in fiscal year 2012.
- **Gas utility oversight and rate setting.** The Commission ensures customers have equal access to natural gas by overseeing gas utility rates for 209 gas utility companies operating in Texas. The Commission has exclusive jurisdiction over the rates of 31 gas utility companies operating in unincorporated areas and appellate jurisdiction over rates set inside municipalities. In addition, the Commission audits gas utility companies to ensure compliance with rate and tax regulations; prevents discrimination among gas utilities by ensuring equal access to pipelines; and offers dispute resolution for parties in the natural gas industry. In fiscal year 2012, the Commission heard 13 gas utility rate cases and conducted 134 field audits.
- **Coal and uranium mining.** The Commission regulates coal mining and uranium exploration to help prevent harmful effects to land and water resources, and to ensure the reclamation of mined land. To oversee these mining activities, the Commission evaluates permits, inspects and monitors mining sites, and investigates complaints against mining operators.

Coal mining. The Commission oversees 28 coal mining operations in Texas, completing 464 inspections and pursuing nine enforcement actions in fiscal year 2012. The Commission, using federal funds, also reclaims abandoned coal mines, with more than 90 percent of all abandoned coal mines having been reclaimed.

Uranium exploration. The Commission permits uranium exploration, issuing three new permits and renewing 11 existing permits in fiscal year 2012. Beyond exploration, the Texas Commission on Environmental Quality oversees in situ uranium mining production. For surface mining of uranium, the Railroad Commission has authority to issue permits, although no such permits currently exist in Texas. Similar to coal mines, the Commission uses federal funds to reclaim abandoned uranium mines.

- **Propane oversight and promotion.** All businesses and employees involved in supplying, transporting, or distributing propane in Texas must obtain a license from the Commission after meeting specified training and testing requirements. The Commission also inspects propane facilities and enforces propane-related laws and rules. In fiscal year 2012, the Commission issued 4,992 licenses, conducted 295 training courses, administered 4,458 exams, performed some 15,000 inspections, and identified nearly 18,000 violations that resulted in 62 propane-related enforcement actions.

The Commission also promotes the consumption of propane, a function funded by delivery fees paid by the propane industry and from state and federal grants. Marketing activities include providing rebates to purchasers of propane appliances and offering grants to local governments and fleet operators who replace old vehicles with new propane fueled vehicles. In fiscal year 2012, the Commission issued 1,725 consumer rebates and awarded 1,153 grants, totaling more than \$9.5 million.

¹ S.B. 1, 82nd Texas Legislature, 1st Called Special Session, 2011.

ISSUES

ISSUE 1

Changing the Railroad Commission's Name and Addressing the Appearance of Conflicts of Interest Remain Critical to Ensuring Transparent and Effective Regulation.

Background

The Railroad Commission of Texas (Commission) is a regulatory agency that principally oversees the oil and gas industry. The Commission works to promote responsible oil and gas production by permitting drilling, overseeing production sites, remediating land polluted or otherwise impacted during production, and ensuring the safe transportation of oil and gas products through the state's pipeline system. In addition, the Commission oversees rates charged by investor-owned gas utilities, regulates coal mining and uranium exploration, and encourages the use of propane as an alternative fuel.

Three statewide elected officials comprise the Railroad Commission. These officials serve staggered, six-year terms, with one Commissioner seeking election every two years.¹ The Commissioners elect their own chair, traditionally rotating it to the member next up for reelection; and if a vacancy occurs, the Governor appoints a new member until the next general election.² These full-time Commissioners meet twice a month in regularly scheduled conferences to promulgate rules to establish regulatory policy and implement legislation, render decisions in contested cases, and handle other administrative matters. Although many responsibilities are delegated to senior staff, the Commissioners generally oversee the administration of the agency. In fiscal year 2012, the Commission operated with a budget of \$74.7 million and 705 staff.

The Commissioners render decisions in different types of contested cases, two of which are addressed in this issue — enforcement cases and gas utility rate cases. Enforcement cases result from the agency's efforts to take action against a party for violating any laws or rules under the Commission's jurisdiction. Gas utility rate cases stem from the Commission's responsibility to ensure the fair and equitable gas rates of certain monopoly gas utilities. The Commission has original jurisdiction over the rates of 31 investor-owned gas utility companies operating in unincorporated areas outside any cities' boundaries. Cities have rate jurisdiction over investor-owned utilities within their boundaries, but utilities may appeal city decisions to the Commission. In fiscal year 2012, the Commission heard 22 contested enforcement cases, 83 default enforcement cases, and 13 docketed gas utility rate cases.

Findings

The agency's name continues to be confusing to the public, not reflecting its important regulatory duties at a time of significant expansion of drilling in the state.

The 2011 Sunset Commission found that the Railroad Commission's name does not reflect its current and very important duties, as the Legislature transferred the agency's last rail oversight functions to the Texas Department of Transportation in 2005.³ Despite its roots in Texas history, the Commission's

Members of the public regularly call the Commission with complaints about rail noise and safety.

name is confusing and unclear to the increasing number of people coming into contact with oil and gas production, particularly as drilling encroaches on suburban and urban areas of the state. With that exploration, greater numbers of Texans are affected by this industry, but may not know whom to contact with questions or complaints. In the case of an emergency, the unclear link between the Commission's name and its regulatory duties could create potential risks to public safety. In addition, members of the public continue to mistakenly call the Railroad Commission with complaints regarding rail noise and safety, which staff have no ability to address but must take time to appropriately reroute.

Compounding these concerns is the potential for voters to be confused about the role and duties of the statewide elected Commissioners, given the agency's outdated name. In point of fact, an unsuccessful candidate actually included railroad safety as part of his campaign platform.⁴ The name and purpose of an agency for which the public is electing statewide Commissioners should not be so clearly misleading.

As the Railroad Commission's Sunset bill with the name change did not pass during the 2011 legislative session, this change in law remains appropriate and much needed.⁵ Last session, the Sunset bill would have changed the agency's name to the Texas Oil and Gas Commission. A number of interested parties have since suggested changing the name to the Texas Energy Commission instead. Sunset staff's concern with this alternative stems from the fact that the term energy — in addition to oil and gas — also encompasses electricity, which is regulated by the Public Utility Commission, not the Railroad Commission. For example, at the national level, the Federal Energy Regulatory Commission regulates the interstate transmission of electricity, natural gas, and oil. This alternative poses the potential for further confusion to the public — the primary reason for changing the name of the agency in the first place.

To address this potential for confusion, Sunset staff recommend consideration of a different alternative — the Texas Energy Resources Commission (TERC). This name, in contrast to the Texas Energy Commission, incorporates the term energy, but modifies the name to avoid the confusion with the regulation of electricity. In contrast to the Texas Oil and Gas Commission, this name also incorporates more of the agency's current duties, including coal mining, uranium exploration, and propane oversight.

The Commission is the only Texas state agency headed by three full-time elected officials.

Having three statewide elected Railroad Commissioners continues to be an anomaly and poses conflicts for the agency's regulatory role.

The Commission's policymaking structure, created in 1894 to oversee transportation, continues to be an anomaly as the only Texas state agency headed by a three-member, full-time elected body. Although statewide elected officials clearly represent the public, critics consistently raise concerns that the appearance of conflicts may arise when such individuals head a

regulatory agency. Elected officials rely on campaign contributions to seek office, re-election or otherwise, creating an opportunity for regulated entities to provide campaign contributions to Commissioners they believe will be sympathetic to their issues.

Other major concerns raised during the previous Sunset review and public hearings were the lack of accountability, administrative costs, and insufficient workload tied to having three full-time elected Commissioners.⁶ The Sunset Staff Report found that maintaining three full-time Commissioners, each with their own staff, annually costs the State about \$1.1 million.⁷ Other agencies headed by full-time elected officials generally have fewer costs and clearer accountability through a single commissioner, for example the Commissioner of Agriculture, General Land Office Commissioner, Attorney General, and Comptroller of Public Accounts.

To address these concerns, the 2011 Sunset Commission recommended changing the structure of the three-member, elected Commission.⁸ However, these proposed structural changes resulted in significant debate throughout the 2011 Legislative Session, and were seen as one of the key reasons for the bill failing to pass. Initially, Sunset staff recommended moving to a five-member, appointed body to avoid these conflicts, however, the Sunset Commission instead recommended changing the structure to a single, elected commissioner to improve accountability. The single commissioner governance structure was adopted by the Senate, but the House version of the bill returned to the three elected members but with an elected chair to head the agency.⁹

With no clear consensus between the Senate and House versions of the Sunset bill on the Railroad Commission at the end of the 2011 Legislative Session, the bill failed to pass. Through separate legislation the Legislature continued the Railroad Commission until 2013 and provided for the Sunset Commission to re-examine the agency in full and make recommendations to the 83rd Legislature regarding its continuation and functions.¹⁰

Sunset staff — as part of this current review — re-examined the original problems to determine other changes that could address these issues without requiring a major change in the agency's structure. While not recommending a change to the structure of the three-member elected Commission, the following material elaborates on related issues of ongoing concern.

- **Campaign contributions.** The Sunset Commission heard public testimony in December 2010 expressing concern about campaign contributions for candidates for the Railroad Commission reaching into the millions, with an increasing majority of funds coming from the regulated community.¹¹ Another concern expressed was that funding was no longer limited to election years, with Commissioners receiving contributions throughout their six-year terms.¹² Witnesses testified that it was hard to fully divorce contributions from decisions with tens of thousands of dollars donated every month.¹³ These circumstances make

With no clear legislative consensus on Commission structure, staff focused on other ways to address ongoing concerns.

it difficult to assure the public that the Commission's regulatory decisions are made solely in the public's interest, not simply in favor of large donors — especially when many key Commission decisions, rightly or not, favor the industry.

Increasing industry contributions make it difficult to assure the public of objective regulatory decisions.

In response to this testimony, the Sunset Commission recommended limiting when Railroad Commissioners and candidates seeking the office could receive campaign contributions — essentially only allowing contributions for the year before the general election and for about a month after the election.¹⁴ After careful analysis, Sunset staff has concluded that, despite recent U.S. Supreme Court decisions, nothing has changed that would affect the continued appropriateness of these recommendations. A major alteration in campaign finance law came from the U.S. Supreme Court decision in *Citizens United* case, which dealt with the narrow question of limitations on corporate campaign expenditures.¹⁵ While this case raised numerous questions about the constitutionality of other campaign contribution restrictions that the Supreme Court may address in the future, such as limitations on direct corporate campaign contributions and blanket restrictions on accepting contributions from a particular class of contributors, under current law the Sunset Commission's recommendations from January 2011 remain appropriate.

Sunset staff also reviewed several modifications added during the 82nd Legislative Session that would further the Sunset Commission's intent to limit the appearance of conflicts or simply make the provisions more workable. One such adjustment was to start the one-year contribution limitation period prior to the primary, instead of the general election. With primaries generally occurring in April of even-numbered years, this would have started the period one year earlier in April of odd-numbered years. This timing would conflict with the prohibition against a statewide officeholder or officer-elect from knowingly accepting a political contribution in the period beginning 30 days before a regular legislative session until 20 days after final adjournment, as regular sessions run from January to June of odd-numbered years. However, recognizing that certain primaries may determine the outcome of a race, this concern should be addressed to the extent that it does not conflict with the legislative session restriction.

Accepting contributions from parties with contested cases before the Commission poses a particularly egregious conflict.

Another more substantive change added by the House to address a particularly egregious conflict would prohibit a Commissioner from knowingly accepting a contribution from a party with a contested case before the Commission.¹⁶ Sunset staff concluded that bringing these provisions forth for the current Sunset Commission's consideration would be appropriate.

In the same vein, an additional tool to increase transparency of these contributions would be to require the posting of Commissioner campaign contribution information on the Railroad Commission website. Under

current law, the Texas Ethics Commission compiles information on campaign contributions to elected officials, including the Railroad Commissioners.¹⁷ While available through the Ethics Commission, this same information would be significantly more accessible to concerned stakeholders if posted directly on the agency's own website.

- **Resign to run.** Another provision aimed at addressing potential conflicts of interest added in the House version of the agency's Sunset bill provided for the automatic resignation of a Commissioner announcing or becoming a candidate for an elected office in any general, special, or primary election, except in the final year of a term or if running for reelection to the Commission.¹⁸ Over the years, the office of Railroad Commissioner has often been used as a springboard for persons aspiring to run for higher office, with five of the last nine former Commissioners having run for other offices while still serving on the Commission. Campaigning for a different elected office can divert Commissioners' attention and take away from their full-time jobs at the agency.
- **Recusal.** Aimed at avoiding conflicts and increasing transparency, a recusal provision was also added to the House version of the Sunset bill.¹⁹ The provision would have required a Commissioner who voluntarily recused himself or herself from a decision to disclose the reason in writing. Sunset staff compared this requirement to recusal policies adopted by other state agency decision-making boards. While most often associated with judges who must recuse themselves in a proceeding in which their impartiality might reasonably be questioned, a number of state agencies have adopted recusal policies for use in administrative law proceedings, including the Public Utility Commission, State Board of Public Accountancy, and Credit Union Commission.^{20, 21}

While members of the Railroad Commission have recused themselves on occasion, the Commissioners have no specific policies guiding these voluntary decisions. In comparison, the Public Utility Commission has formally adopted rules that set the standards, requirements, and procedures for recusal of a commissioner.²² Having such a policy would help clarify when Commissioners must recuse themselves to avoid any appearance of bias based on a personal or financial interest in an item up for decision.

Campaigning for another office diverts a Commissioner from their full-time duties at the Railroad Commission.

Railroad Commissioners have no specific policies guiding recusal.

The need for neutral, independent staff to preside over contested enforcement and gas utility cases remains critical to ensure the fair and unbiased treatment of all parties.

The 2010 Sunset review found the Railroad Commission, unlike other state regulatory agencies, relies on its own staff attorneys to preside over contested enforcement hearings and gas utility rate cases instead of using the State Office of Administrative Hearings (SOAH). Despite not supporting the transfer of gas utilities to the Public Utility Commission, if kept at the Railroad Commission, the Sunset Commission recommended that gas utility cases be

handled by SOAH to ensure outside objectivity.²³ For enforcement cases, the Sunset Commission also adopted the staff recommendation to transfer these hearings to SOAH. Neither of these provisions made it into law, as the Sunset bill failed to pass.²⁴

Having in-house attorneys preside over contested cases gives the appearance of bias.

The purpose of having SOAH conduct hearings is to ensure fair and impartial treatment of all the parties to a case. Having in-house attorneys hear the cases at the Railroad Commission can give the appearance of a conflict of interest, as these staff must preside as a neutral entity independent of other Commission staff participating in the contested case as one of the parties. The hearing staff also answer to the elected Commissioners who receive campaign contributions from many of the industry parties in these cases. This relationship can create the perception of bias towards the industry and can lead to public mistrust in the Commission, even if no conflict exists. For example, the Comptroller of Public Accounts chose to transfer tax hearings to SOAH to assure taxpayers that they would receive fair and impartial treatment in tax disputes.²⁵

In reevaluating this issue, Sunset staff found the Commission has taken steps to separate technical staff with party status and staff involved with decision making in administrative hearings into different divisions. While reducing the potential for inadvertent ex-parte communication, in-house hearings examiners remain subject to the overall pressures of working within the agency. Thus, the reasons for transferring these hearings to SOAH have not changed. Despite industry claims of additional costs and time delays, Sunset staff could find no convincing evidence to support these allegations, and even to the extent these concerns have any merit, they would not outweigh the need for an impartial hearings officer.²⁶

Existing laws on timely decisions in utility rate cases would ensure SOAH's prioritization of these cases.

SOAH clearly has the expertise — hearing contested cases is what they do. In fiscal year 2012, SOAH conducted 25,832 hearings for 49 agencies and government entities. SOAH administrative law judges (ALJs) are trained to run hearings fairly and efficiently. SOAH operates with performance measures to ensure cases do not linger on the docket and that, once a case is closed, the ALJ completes the proposal for decision within 60 days. In addition, existing provisions in law that require timely action on proposed gas utility rate increases would continue, ensuring SOAH would prioritize these cases since missing the deadline would mean the utility's proposed rate increase would go into effect automatically.²⁷

SOAH has teams devoted to hearing both enforcement and utility rate cases. SOAH routinely hears complex enforcement cases that involve highly technical matters, such as cases involving the Texas Commission on Environmental Quality and Public Utility Commission. SOAH also has the capability to conduct hearings throughout much of the state through its seven field offices and 31 remote-site hearing locations, greatly facilitating conduct of a hearing closer to where the parties reside when appropriate.

The 2011 Sunset Commission recommendation to continue the Commission remains appropriate, but would need to be adjusted to align with other related Sunset reviews.

The 2011 Sunset Commission recommendation to continue the agency remains appropriate. Texas has a continuing need to regulate the production, transportation, and distribution of oil, natural gas, and other critical energy resources. Unregulated production of oil and natural gas could detrimentally affect public safety and the environment, and significantly hinder future production recovery efforts. The Commission's role in overseeing surface coal mining provides needed environmental protection, ultimately ensuring that mined land is restored to its pre-mining, productive condition. Gas utility oversight ensures that utility companies — most operating as monopolies — charge fair rates to gather, transport, and distribute natural gas to end users in both cities and rural areas. In addition, although most states oversee oil and gas production through an environmental agency, the magnitude of Texas' oil and gas industry continues to warrant a separate oversight structure.

As originally envisioned, the Sunset Commission recommendation would have placed the agency under review again in 12 years, or in 2023. To continue to align the agency's review with the Sunset reviews of other related agencies — the Texas Commission on Environmental Quality and Public Utility Commission — this review date should be maintained, necessitating review again in 10 years, rather than the standard 12-year period.

- **Across-the-Board Recommendation.** As part of this current review, Sunset staff also evaluated the ongoing appropriateness of a standard across-the-board provision previously adopted by the Commission in 2011 for application to the Railroad Commission regarding a plan for encouraging negotiated rulemaking and alternative dispute resolution. The purpose is to encourage the use of more open, inclusive, and conciliatory processes designed to solve problems by building consensus rather than through contested proceedings. Sunset staff concluded that this recommendation remains appropriate.

While most states use an environmental agency to oversee oil and gas production, the magnitude of Texas' industry continues to warrant a separate structure.

Recommendations

Change in Statute

1.1 Change the name of the Railroad Commission of Texas to the Texas Energy Resources Commission and continue the agency for 10 years.

This recommendation would continue the agency in the same capacity, renaming the Commission to ensure increased transparency for its primary role in overseeing energy resource exploration and production in Texas — eliminating confusion regarding any ongoing role with railroads, as it has none. Under this recommendation, the Commission would be required to adopt a timeframe for phasing in the agency's new name, so as to spread out any limited costs associated with updating letterhead, signs, publications, and other official agency documents. Continuing the Commission for 10 years, rather than the standard 12-year period, would keep the agency's Sunset review aligned with other related agency reviews.

In addition, this recommendation would apply the standard Sunset across-the-board requirement for the Commission to develop a policy that encourages alternative dispute resolution and negotiated rulemaking. This change would ensure the Commission considers the merits of applying these practices to its rulemaking, internal employee grievances, and other appropriate potential conflict areas.

1.2 Limit the solicitation and receipt of campaign contributions by a Commissioner or any candidates seeking the office to a year and a half timeframe around the election, rather than throughout the full six-year term.

This recommendation would limit a Commissioner and any candidates seeking office as a Commissioner to soliciting and receiving campaign contributions in an 18 month period, starting 17 months before the election and ending one month after the election. Thus, for the general election on November 4, 2014, Commissioners could accept donations from July 4, 2013 to December 4, 2014. This would provide adequate time for fund raising before the primary and general elections, but would not allow fundraising throughout the person's full six-year term. This timeframe also complies with existing prohibitions against these persons accepting contributions during the time around a regular legislative session.

As part of this recommendation, statute would require the Commissioners to regularly post campaign contributions on the Commission's website. The posted information would be the same information that Commissioners already provide to the Texas Ethics Commission — it would simply ensure easier and quicker access to interested parties by posting it on the agency's own website. This information should include, at a minimum, by Commissioner, the name of the entity making the donation, the amount, and the date. Posting this information would increase transparency of these contributions and make them more accessible to interested stakeholders.

1.3 Prohibit a Commissioner from knowingly accepting contributions from a party with a contested case before the Commission.

This recommendation would prohibit a Commissioner from knowingly accepting a political contribution from a party, or political committee affiliated with the party, with a contested case before the Commission. The timeframe for this prohibition would extend from the date the hearing is set until the 30th day after the hearing ends. Staff at the agency would need to keep a running list of contested cases within these timeframes, along with the parties to the case, to facilitate the Commissioner's compliance with this requirement. Any contribution accepted by mistake must be returned.

1.4 Require the automatic resignation of a Commissioner that announces or becomes a candidate for another elected office.

This recommendation would include announcing or becoming a candidate for an elected office in any general, special, or primary election, except if a Commission member chooses to run for reelection to the Commission. This change would ensure that Commissioners opting to run for other office have to resign from their full-time jobs at the agency. To allow Commission members to run for other offices at the end of their terms, this provision would not apply in the last 18 months of their terms. This would coincide with Recommendation 1.2 that would allow a member to solicit and receive contributions within the same timeframe.

1.5 Require the Commission to adopt a recusal policy in rule, including a requirement to explain the reason for any recusal from a decision in writing.

This recommendation would require the Commission to formally adopt rules that set the standards, requirements, and procedures for recusal of a Commissioner. This policy should include a requirement for Commissioners that recuse themselves from a decision to explain the reason in writing. Having such a policy would help clarify when Commissioners must recuse themselves to avoid any appearance of bias based on a personal or financial interest in an item up for decision.

1.6 Require the Commission to use the State Office of Administrative Hearings to conduct independent hearings for its contested gas utility and enforcement cases.

Under this recommendation, the Commission would contract with SOAH to conduct the Commission's hearings for contested gas utility cases and contested enforcement cases. In conducting hearings, SOAH would consider the Commission's applicable substantive rules and policies.

Like other agencies that have hearings conducted at SOAH, the Commission would maintain final authority to accept, reverse, or modify a proposal for decision made by a SOAH judge. The Commission could reverse or modify a decision only if the judge did not properly apply or interpret applicable law, Commission rules, written policies, or prior administrative decisions; the judge relied on a prior administrative decision that is incorrect or should be changed; or the Commission finds a technical error in a finding of fact that should be changed. If the Commission does make a change, the reason for such change should be clearly documented and must still be based on evidence in the record.

Fiscal Implication

These changes overall would have no net fiscal impact to the State. Changing the agency's name would have no significant fiscal impact as the Commission should phase in these changes over time using existing resources.²⁸ The recommendation to require the use of the State Office of Administrative Hearings to conduct gas utility and enforcement hearings would add four FTEs to SOAH at a cost of about \$440,000, with a corresponding reduction of staff and savings at the Commission. The Commission would use these savings to pay SOAH for conducting the hearings.

In addition, the recommendation to continue the Commission for 10 years would require the continuing legislative appropriation of about \$75 million annually to cover the costs of the agency's operations.

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- 1 Section 30, Article XVI, Texas Constitution.
 - 2 Ibid.
 - 3 Article 6445, Vernon's Texas Civil Statutes.
 - 4 "Derail the RRC," DownstreamToday.com, Last Modified February 26, 2008, <http://www.downstreamtoday.com/News/ArticlePrint.aspx?aid=8935&AspxAutoDetectCookieSupport=1>.
 - 5 S.B. 655, 82nd Texas Legislature, Regular Session, 2011.
 - 6 Texas Sunset Advisory Commission (SAC), *Sunset Advisory Commission Final Report on the Railroad Commission of Texas* (Austin: Texas Sunset Advisory Commission, 2011) pp. 16-17.
 - 7 Ibid.
 - 8 SAC, *Final Report on the Railroad Commission of Texas*, p. 20f.
 - 9 C.S.S.B. 655, 82nd Texas Legislature, Regular Session, 2011.
 - 10 S.B. 652, 82nd Texas Legislature, Regular Session, 2011.
 - 11 Public testimony before the Texas Sunset Advisory Commission (Austin, TX, December 15, 2010).
 - 12 Ibid.
 - 13 Ibid.
 - 14 SAC, *Final Report on the Railroad Commission of Texas*, p. 20f.
 - 15 *Citizens United v. Federal Election Commission*, 558 U.S. 310 (2010).
 - 16 C.S.S.B. 655, 2011.
 - 17 Section 571.066, Texas Government Code.
 - 18 C.S.S.B. 655, 2011.
 - 19 Ibid.
 - 20 Rule 18b, Texas Rules of Civil Procedure.
 - 21 16 T.A.C. Section 22.3; 22 T.A.C. Section 505.13; and 6 T.A.C. Section 97.103.
 - 22 16 T.A.C. Section 22.3.
 - 23 SAC, *Final Report on the Railroad Commission of Texas*, p. 66j.
 - 24 Ibid.
 - 25 Senate Research Committee, *Highlights of the 80th Texas Legislature* (Austin: Senate Research Committee, 2007) pp. 8-9.
 - 26 Public testimony before the Texas Sunset Advisory Commission (Austin, TX, December 15, 2010).
 - 27 Sections 104.102 and 104.107(a)(2), Texas Utilities Code.
 - 28 Fiscal Note, S.B. 655, 82nd Texas Legislature, Regular Session (March 27, 2011).

ISSUE 2

Self-Funding of the Oil and Gas Program Is Working Well, But Would Benefit From Removal of the \$20 Million Cap on the Oil and Gas Regulation and Cleanup Fund.

Background

During the 82nd Session, the Legislature made a number of changes to the Railroad Commission's (Commission's) sources of funding, including making its Oil and Gas program self-supporting by replacing general revenue with fees and surcharges paid by the industry.¹ Prior to these changes in funding, the Commission deposited all fees, fines, and miscellaneous revenues associated with the regulation of the oil and gas industry into the Oil Field Cleanup Fund. Funds in this General Revenue dedicated account were used to plug abandoned oil and gas wells and for site remediation.

In 2011, the Legislature reconstituted the Oil Field Cleanup Fund as the Oil and Gas Regulation and Cleanup Fund (Fund) and directed all fees and surcharges to be deposited in the newly repurposed Fund, which is capped in statute at \$20 million.² If the Commission exceeds the \$20 million Fund cap, the Commission is prohibited, by statute, from levying oil and gas fees until the Fund balance is reduced below \$10 million. At the end of fiscal year 2012, the Fund had a balance of \$17 million, including \$8 million in unencumbered funds and \$9 million in encumbered funds — contracts for well plugging and site remediation, and Underground Injection Control grants. The textbox, *Major Purposes of the Oil and Gas Regulation and Cleanup Fund*, summarizes the reconstituted Fund's statutory uses.³

Major Purposes of the Oil and Gas Regulation and Cleanup Fund

- Oversee all aspects of oil and gas production, including permitting, monitoring, inspecting, public information, and administration.
- Conduct site investigations to determine the nature and extent of contamination caused by oil and gas waste.
- Remediate oil and gas waste that cause, or may cause, pollution to surface or subsurface water.
- Plug abandoned wells and enforce orders and rules related to oil and gas pollution.

The original Oil Field Cleanup Fund also had an advisory committee that the Legislature created in 2001 to oversee the administration of oil field cleanup efforts and report to the Legislature the progress of plugging abandoned wells in Texas. Statute establishes this 10-member Committee composed of two legislators, five industry representatives, two members from the academic community, and a public member.⁴

Findings

The Sunset Commission's 2011 recommendations that authorized the Railroad Commission to levy surcharges and make its Oil and Gas program self-supporting were adopted by the Legislature and implementation efforts are well underway.

In 2011, based on recommendations from the Sunset Commission, the Legislature authorized the Commission to levy surcharges to make its Oil and Gas program self-supporting, and decreased the amount of General Revenue the Commission receives to correspond with these increases in surcharges.⁵ Before last session, the Commission's Oil and Gas program was appropriated about \$53 million in fiscal year 2011, including 65 percent from fees and fines in the Oil Field Cleanup Fund and 35 percent from General Revenue. Following these changes, the Commission's Oil and Gas program received an appropriation of about \$54 million in fiscal year 2012, including 85 percent from fees and surcharges. The Commission's Oil and Gas program would have been 100 percent self-funded, but for a general revenue appropriation of \$10 million for additional staffing in fiscal years 2012-2013.⁶ The Legislature directed these fees and surcharges into the newly repurposed Oil and Gas Regulation and Cleanup Fund. In addition, the Legislature redirected fines previously deposited in the Oil Field Cleanup Fund to the General Revenue Fund, as recommended by the Sunset Commission.

Changes to the Commission's sources of revenue have enabled the Commission to increase the number of full-time oil and gas inspectors from 87 in 2010, when the Commission was last under Sunset review, to 97 full-time inspectors in 2012. With this increase in staffing, the Commission has dedicated more field staff to perform inspections, as described further in Issue 4.

The Oil and Gas Regulation and Cleanup Fund has out grown the purpose of its statutory cap.

Although most changes to the Commission's funding sources have gone smoothly and are working well, Sunset staff found that the \$20 million cap on the Oil and Gas Regulation and Cleanup Fund likely will restrict the Commission from providing sufficient funding for its regulatory and cleanup operations. The Legislature created the original Oil Field Cleanup Fund as a General Revenue dedicated account for the limited purpose of using fee and fine revenue to plug abandoned oil and gas wells and cleanup polluted oil field sites. At the time the Oil Field Cleanup Fund was created, the Legislature capped the dedicated account at \$20 million to limit the amount of fees the Commission could collect to fund its well plugging and cleanup operations. However, in 2011 the Legislature repurposed this dedicated account to fund all oil and gas regulatory activities, including permitting, inspecting, and well plugging.

With the exception of the cap on the Fund, changes to the Commission's funding structure have gone smoothly.

While appropriate for its previous limited role, the cap no longer works for all oil and gas regulation.

This newly reconstituted fund, the Oil and Gas Regulation and Cleanup Fund, now serves a much larger purpose, but remains capped at \$20 million. However, the amount of revenue the Commission generates from surcharges, which are deposited into the Fund, has increased. Although the cap on the Fund was appropriate at the time it was initially created, the expanded purpose of the Fund and the additional revenue the Commission now generates from surcharges requires the Commission to have more flexibility in its maximum balance.

The \$20 million cap on the Fund restricts the Commission from increasing statutorily authorized surcharges to adequately fund its oil and gas regulatory and cleanup operations.

At the same time the Legislature expanded the use of the Fund, it also required the Commission's Oil and Gas program to be self-supporting, authorizing the Commission to levy surcharges on the program's permits to achieve this purpose. Surcharges are capped in statute at 185 percent of fees and are deposited in the Oil and Gas Regulation and Cleanup Fund.⁷ However, because oil and gas production has increased at an exponential rate, the number of new permits filed by operators has also increased and has resulted in the Commission collecting more surcharges; thus, putting the Commission at risk of exceeding the Fund's \$20 million cap. For example, in fiscal year 2012, the Commission collected more than \$36 million in fees and surcharges and was appropriated \$5 million in general revenue. As a result, the Fund balance grew to \$17 million, only \$3 million below the cap.

The Fund's cap also limits the Commission's ability to hire more field inspectors and make improvements to its information technology (IT) systems. The Commission estimates that increasing surcharges from 150 percent, its current rate, to 185 percent, its statutory max, would generate an additional \$14 million per year. This additional revenue from increasing surcharges could be used to hire additional staff and make much needed IT enhancements, but would likely push the Commission over the Fund's cap.

The Sunset Commission's 2011 recommendation to abolish the Oil Field Cleanup Fund Advisory Committee continues to be appropriate.

The 2010 Sunset review found that, while the need for plugging abandoned wells continues, the purpose of the Oil Field Cleanup Fund Advisory Committee (Committee) has been accomplished. The Legislature created the Committee to meet quarterly with the Commission, monitor and report the effectiveness of the Oil Field Cleanup Fund, review recommendations for legislation proposed by the Commission, and review rules relating to the Oil Field Cleanup Fund.⁸ Although the Oil Field Cleanup Fund was renamed and reconstituted to serve a larger purpose, the Committee continues to only serve in its advisory role for the Commission's cleanup functions. However, the Commission's well plugging efforts are on track. Illustrating its progress,

With exponential growth in oil and gas production, the Commission may soon risk exceeding the cap.

The Oil Field Cleanup Fund Advisory Committee has achieved its purpose and is no longer needed.

the number of abandoned wells requiring plugging has diminished from about 18,000 in fiscal year 2002 to less than 8,000 in fiscal year 2012. Meeting records of the Committee also support this conclusion. The Committee has only met once in the past two years, missing its quarterly meeting and biennial reporting requirements. In addition, agency staff routinely track and report to the Railroad Commissioners and the Legislature on these ongoing efforts.

Recommendations

Change in Statute

2.1 Eliminate the cap on the Oil and Gas Regulation and Cleanup Fund.

This recommendation would remove the \$20 million cap on the Oil and Gas Regulation and Cleanup Fund from statute. The cap restricts the Commission from adequately staffing and performing its oil and gas regulatory duties, in conflict with the intent of self-funding a quality regulatory program. As is the case with most other state agencies, without a funding cap the Commission could only spend funds at the level appropriated by the Legislature. The Commission would continue to adjust surcharges, within the 185 percent limit.

In conjunction with Issue 8 of this report, the Commission would continue to produce its report on the Oil and Gas Regulation and Cleanup Fund to the Legislature and the Legislative Budget Board. This quarterly report includes information on the performance goals for the Fund; the balance of the Fund; the amount of fees and surcharges deposited into the Fund; the amount spent from the Fund and for what purposes; the number of wells plugged and the number of abandoned wells that remain unplugged; and any other information that relates to the Commission's regulatory and cleanup duties. The Commission must also place this report on its website for the public and oil and gas industry to access.

2.2 Abolish the Oil Field Cleanup Fund Advisory Committee.

This statutory Committee has served its purpose and is no longer needed. This recommendation would repeal the statute establishing the Committee. In addition, this recommendation would abolish the Committee's statutory reporting requirement to provide information on the administration of the Oil Field Cleanup Fund and the progress the Commission has made towards plugging abandoned wells. As discussed in Recommendation 2.1, the Commission would provide the information previously contained in the Committee's Cleanup Fund report, including information on the administration of the Fund and the progress the Commission has made towards plugging wells.

Fiscal Implication

The recommendation to eliminate the \$20 million cap on the Fund would ultimately have no direct fiscal impact to the State. The Commission would only increase surcharges to generate revenue sufficient to support amounts appropriated by the Legislature. Abolishing the Oil Field Cleanup Fund Advisory Committee would also have no fiscal impact because the Committee receives no funding.

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- ¹ S.B. 1 and S.B. 2, 82nd Texas Legislature, 1st Called Session, 2011.
 - ² S.B. 1, 2011.
 - ³ Section 81.068, Texas Natural Resources Code.
 - ⁴ Section 91.1135, Texas Natural Resources Code.
 - ⁵ S.B. 2, 2011.
 - ⁶ Section, 18.11 (p. IX-74 and 75), S.B. 1, 82nd Texas Legislature, 1st Called Session, 2011.
 - ⁷ S.B. 1, 2011.
 - ⁸ S.B. 310, 77th Texas Legislature, Regular Session, 2001.

ISSUE 3

The Commission's Current Pipeline Safety Fee Does Not Cover the Program's Costs, Limiting the Agency's Ability to Ensure Public Safety Within a Growing Oil and Gas Industry.

Background

In 1917, the Legislature authorized the Railroad Commission of Texas (Commission) to regulate intrastate pipelines and required all pipelines and gathering systems that transport oil or gas in the state to receive a permit from the Commission. The Commission's Pipeline Safety program permits pipeline operators, audits pipeline operators and their records, performs field inspections, conducts accident investigations, responds to emergencies, and provides educational programs to excavators and pipeline operators.¹ In fiscal year 2012, the Commission issued or renewed more than 3,500 permits to operate a pipeline; performed more than 3,300 inspections of Texas' 170,000 miles of intrastate pipelines; identified more than 2,700 violations; conducted 175 accident investigations and special investigations; and completed 3,800 enforcement actions against excavators and pipeline operators.

To support its Pipeline Safety program, the Commission levies a pipeline safety fee on all natural gas distribution and municipal operators on a per service line basis.² Natural gas utilities pass this pipeline safety fee on to gas utility customers each year in their utility bill. Statute caps the pipeline safety fee at \$1 per service line and the Commission has currently set the fee, by rule, at \$0.75 per line.³ In fiscal year 2012, the Commission collected about \$3.7 million in pipeline safety fees to fund its Pipeline Safety program. In addition, the Commission received \$2.4 million in federal funds and the Legislature appropriated about \$1.5 million in general revenue to cover the program's remaining costs.

Finding

The Commission does not have statutory authority to assess a fee for a permit to operate a pipeline, limiting the Commission's ability to ensure public safety and oversight of a growing industry.

As part of its permitting process, the Commission requires pipeline operators to provide basic information, including the location and mileage of the pipeline, the type of fluid transported, the outside diameter and wall thickness of the pipe, the pipe grade, the maximum allowable operating pressure, the purpose for which the pipeline will be used, and other information related to the operator. The Commission uses the information included in the pipeline permit, known as the T-4 permit, to ensure public safety and the integrity of the pipelines. While the Commission has required pipeline operators to receive such an upfront permit to operate a pipeline from the Commission for more than 90 years, it has never charged operators a permit fee to support this function.

The Commission has required pipeline operators to get permits for 90 years, but has never charged a fee.

Most regulatory agencies require the regulated entity to pay a permit fee on the front-end to support its regulatory functions. The Commission, however, funds its Pipeline Safety program by levying a pipeline safety fee on gas utility customers. This back-end fee is not tied to the Commission's permitting process or to the increasing number of miles of regulated pipelines in the state. In addition, this consumer fee does not cover all of the Pipeline Safety program's costs.

Current back-end consumer fees do not cover the full costs of regulating pipelines in the state.

Not charging an upfront permit fee also limits the Commission's ability to generate sufficient revenue to keep pace with growth in the oil and gas industry. The Barnett Shale and Eagle Ford Shale regions, for example, have seen production increase at an exponential rate and, as a result, the mileage of pipelines to transport these resources from the wellhead to the burner tip has also increased; thus, increasing the need to adequately fund and staff the Commission's Pipeline Safety program. Assessing a permit fee would enable the Commission to employ sufficient staff and field inspectors, allow the Commission to ensure pipelines are safely transporting oil and gas across the state, and allow the Commission to appropriately oversee an important industry that continues to grow.

Recommendations

Change in Statute

3.1 Authorize the Commission to create a pipeline permit fee to help support its Pipeline Safety program.

This recommendation would enable the Pipeline Safety program to be self-supporting by authorizing the Commission to create a new T-4 pipeline permit fee, adjustable by the Commission. The Commission could adjust the newly created T-4 permit fee to meet the growing needs of the program, but within limits established by the Legislature. The Commission would collect the permit fee at the time of application.

Under this recommendation, the Commission would establish a methodology for developing the fee that reflects the time needed to perform the regulatory work associated with permitting pipelines; the impact of the permit fee on operators of all sizes; and other factors it considers important to the fair and equitable levying of a permit fee. The Commission would have the flexibility to establish methodologies for the fee to cover all program costs, including administration costs and benefits. For example, the Commission could base the fee on the mileage of pipeline, the number of new and renewed permits, the number of amended permits, the number of pipeline systems, or any other factor that enables the Commission to equitably and efficiently recover all costs of its Pipeline Safety program. The Commission would establish the methodology in rule, ensuring the opportunity for affected pipeline operators and the public to comment.

Creating a new T-4 permit fee would provide a mechanism for the Commission, based on legislative appropriations, to generate additional revenue to better ensure public safety by hiring sufficient field inspectors, and to make information technology improvements to meet the needs of a growing oil and gas industry.

Change in Appropriations

3.2 Add language in the General Appropriations Act to further ensure that the Commission collects fee amounts to offset the costs of administering its Pipeline Safety program, including administration costs and benefits.

New rider language would be placed in the Commission's appropriation pattern to require that the pipeline safety and pipeline operator permit fees, and any other miscellaneous revenue associated with the Pipeline Safety program cover, at a minimum, all program costs, including direct and indirect administrative costs as well as benefits. As with a number of these riders, if revenues are insufficient to cover these costs, the Legislative Budget Board and Governor may direct the Comptroller's office to reduce the appropriation authority to be within the amount of fee revenue expected to be available.

Fiscal Implication

These recommendations would have an estimated savings of \$1,499,779 to the General Revenue Fund. Revenue from the newly created T-4 pipeline permit fee would be used to offset the general revenue the Legislature currently appropriates to the Commission for its Pipeline Safety program. Any increase in revenues to support additional inspectors and new information technology would depend on future legislative appropriation requests and are not estimated for this issue.

Railroad Commission of Texas

Fiscal Year	Savings to the General Revenue Fund
2014	\$1,499,779
2015	\$1,499,779
2016	\$1,499,779
2017	\$1,499,779
2018	\$1,499,779

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¹ Chapters 117 and 118, Texas Natural Resources Code; Chapter 121, Texas Utilities Code; and Section 756.126, Texas Health and Safety Code.

² Section 121.211, Texas Utilities Code.

³ 16 T.A.C. Section 8.201.

ISSUE 4

While Changes Have Begun, the Commission Continues to Need Statutory Direction to Improve Its Enforcement Processes.

Background

To ensure compliance with safety and environmental requirements, the Railroad Commission of Texas (Commission) inspects and monitors oil and natural gas production, storage, delivery, and cleanup. Inspections may occur as part of the agency's routine risk-based schedule or in response to a complaint. In fiscal year 2012, the Commission spent more than \$15.7 million on its inspection and monitoring functions, employing 97 full-time oil and gas field inspectors and 55 additional staff that dedicate part of their time to oil and gas field inspections. Since the 2010 Sunset review, the Commission has added 10 new full-time field inspectors, allowing the Commission to dedicate more staff to performing inspections, entering violations into the enforcement database, and assessing the seriousness of each violation.

In fiscal year 2012, Commission inspectors performed more than 118,000 inspections, finding more than 55,000 violations. When inspectors uncover violations of statute or Commission rule, they report the violations to the district office for review, and the agency sends a notice of violation to the operator. To take enforcement action against violators of law or rule, statute gives the Commission a variety of sanctioning options, including administrative penalty authority of up to \$10,000 per day per violation for violations related to safety or the prevention or control of pollution. In fiscal year 2012, the Commission issued 217 penalties, assessing more than \$1.9 million in fines to oil and natural gas operators.

In addition to assessing fines, the Commission has the ability to sever a lease, which allows the Commission to gain compliance without necessarily having to pursue an enforcement action. The Commission can sever a lease, which may include multiple wells, for all oil- and natural gas-related violations, which prevents an operator from producing or selling any petroleum product from a lease until the violation is corrected. In fiscal year 2012, in those instances where the Commission sent a notice of severance, 63 percent of leases with violations were corrected after receiving the notice and an additional 22 percent of leases were corrected after the lease was severed. The remaining 15 percent of these leases were referred to enforcement because the violation was not corrected.

Finding

While the Commission has recently adopted penalty guidelines and is field testing changes to its enforcement policies, these changes are too new to evaluate their impact and statutory direction is still needed to ensure these efforts continue in the future.

One of the key findings of the 2010 Sunset review was that the Railroad Commission initiated a limited number of enforcement actions against noncompliant oil and gas producers and relied on incomplete data to guide its

enforcement process. Sunset found the Commission did not track violations based on the severity of the violation and did not have a formalized process for ranking violations to ensure that serious or repeat offenses were referred for enforcement action. Also of particular concern was the Commission's enforcement process' limited ability to deter future violations.

In August 2012, the Commission adopted new guidelines assigning higher penalties for repeat violations.

While the Commission continues to address compliance through its severance process, it still needs to take additional enforcement action to deter serious and repeat violations. In fiscal year 2012, the Commission forwarded a little more than 2 percent of the 55,000 violations identified by inspectors for enforcement action. The lack of a policy that ranked violations prevented the Commission from being certain that the most serious violations and repeat violations were being consistently forwarded for enforcement action and, as a result, contributed to a public perception of an unwillingness to pursue enforcement action. The Commission needs to take consistent enforcement action against violators to assure the public that the agency is closely monitoring the industry as it continues to expand into suburban areas and affect peoples' day-to-day lives.

Although the Sunset bill failed to pass during the 2011 session, the Railroad Commission, in response to concerns raised through the Sunset process, decided to take action on its own to address many of these issues. In August 2012 the Commission adopted penalty guidelines, in rule, that assign penalties based on the risk posed and the severity of the violation, and assign higher penalties for repeat violations.¹ The Commission publishes its penalty guidelines and enforcement data on its website.

While not formally adopted yet, the Commission is also in the process of revising and field testing changes to its enforcement policies. These changes include ranking violations from "minor" to "major." Minor violations would include violations such as improper signage, while major violations would include anything that can harm public health or the environment. Field staff would refer all major violations for enforcement action, even if the operator comes into compliance. In addition, all severed leases would result in an automatic referral for enforcement. Based on a total of 11,589 severances in fiscal year 2011, this change alone could significantly increase the number of enforcement actions taken by the Commission in the future. The Commission began field testing these changes in September 2012, and states that broader implementation depends on the results of this testing, improvements to its IT system, and the potential need for additional funding and staff to process any significant increases in workload.

A new policy to refer all severed leases for enforcement could significantly increase the total number of enforcement actions.

The Commission is training new staff and has just begun testing these new policies, so the actual impact on the agency's enforcement efforts cannot be determined yet. In fact, while the Commission has improved its tracking mechanisms, analysis of more than just a few months of data will be required before any conclusions can be reached. However, recent trend data does suggest an increase in the number of cases referred for enforcement. These changes appear to have the Commission going in a positive direction; however,

Sunset staff concluded that the statutory recommendations put forth in 2011 remain appropriate as a means for ensuring the Commission maintains these efforts in the future.

Recommendations

Change in Statute

4.1 Require the Commission to develop an enforcement policy to guide staff in evaluating and ranking oil- and natural gas-related violations.

This change in law would require the Commission to develop an overall enforcement policy that includes specific processes for classifying violations based on the risk to public safety or the risk of pollution. Statute would also require the Commission to adopt standards providing guidance to field staff on which type of violations to appropriately dismiss based on compliance, versus violations that should be forwarded to the central office for enforcement action. In addition, the Commission should develop standards that take into account an operator's previous violations and compliance history when determining whether to forward a violation. While the Commission has positive changes underway, placing this requirement in law would help ensure full implementation and continued focus on the Commission's new enforcement efforts, particularly in regards to going beyond simple compliance for serious violations and better deterrence of repeat violations.

4.2 Require the Commission to formally adopt penalty guidelines.

Even though the Commission recently adopted penalty guidelines, placing this requirement in statute would help ensure the Commission maintains such guidelines in the future. This change in law would require the Commission to formally adopt its penalty guidelines, obtaining public input when considering penalty amounts and processes. Statute would require the guidelines to assign penalties to different violations based on their risk and severity, making full use of higher penalties for more serious and repeat violations. In addition, statute would require the Commission to consider the number of times a violator has had a lease severed when determining a penalty amount.

Fiscal Implication

These recommendations would likely generate additional revenue from penalties, which by law must be deposited in the General Revenue Fund. Clarifying violations that staff should refer for enforcement could increase the number of violations forwarded for enforcement, and updating the penalty guidelines could bring in more revenue from fines. Conversely, increased enforcement activity could act to deter certain repeat violations, given that simply coming into compliance would no longer resolve the matter. However, the fiscal impact of these changes could not be estimated because penalty amounts generated would depend on the number and seriousness of future violations, which could vary significantly based on many factors that cannot be predicted.

¹ 16 T.A.C. Section 3.107.

ISSUE 5

The Commission's Promotion of Propane Is No Longer Necessary.

Background

In 1991, the Legislature established the Alternative Fuels Research and Education Division (AFRED), giving the Railroad Commission of Texas (Commission) authority to promote propane and other environmentally beneficial alternative fuels that improve the quality of air in Texas.¹ While authorized to promote other fuels, the Commission primarily promotes propane as this industry alone contributes funds to support this purpose. The Commission, however, has recently started applying for and receiving grants to promote natural gas as an alternative fuel.

The Commission funds its propane promotion function using a statutorily authorized delivery fee paid by the propane industry on the sale of odorized gas, collecting more than \$1.8 million in fiscal year 2012. Such fees fund the Commission's primary promotion activity, a rebate program.² The Commission's rebate program encourages the consumption of propane by providing financial incentives to purchasers of propane appliances. In fiscal year 2012, the Commission issued 1,725 rebates to purchasers of propane appliances, totaling \$247,500. In addition, the Commission issues a monthly propane newsletter, provides educational programs on propane appliances for homebuilders, organizes and conducts seminars on propane vehicles for fleet operators, and researches new ways to use propane as an alternative fuel.

The Commission also distributes grant money from other state and federal agencies to promote the use of propane and natural gas as an alternative fuel. The grants provide funding to local governments and fleet operators who replace old forklifts, school buses, and other medium-duty trucks with new, low-emission propane and natural gas vehicles. In fiscal year 2012, the Commission awarded 1,153 grants to local governments and fleet operators who purchased propane vehicles, totaling more than \$9.5 million. Although the Commission has recently started promoting natural gas, the Commission has not yet awarded any grants to purchasers of natural gas vehicles.

In addition to its propane promotion activities, the Commission also licenses businesses and individuals that supply, transport, or distribute propane. Authorized in statute, the Propane Alternative Fuels Advisory Committee (Advisory Committee) oversees the AFRED program and helps the Commission develop ideas for training and testing, as part of the Commission's propane licensing function. The Advisory Committee also advises the Commission on opportunities to expand the use of propane in Texas.³

Finding

The Sunset Commission's recommendation to eliminate the Railroad Commission's statutory authority to promote the use of propane continues to be appropriate.

The 2010 Sunset review found that a conflict exists between the Commission's role as a regulator of propane and its role as a promoter of propane. Although several changes to AFRED have occurred, none of these changes alter Sunset

staff's overall conclusion that its promotion program unnecessarily conflicts with its role as a regulator when other entities exist that are able to promote propane at a lesser cost to the industry, and ultimately the consumer. The following points summarize problems identified with the Commission's propane promotion program.

Promoting an industry that the Commission also regulates creates the appearance of a conflict of interest.

- **Poses a conflict of interest.** The Commission's primary responsibility is to ensure the safe handling and distribution of propane and to prevent the risk of injury or property loss to workers in the industry and the public. Involvement in promoting propane can give the appearance of conflicting with its regulatory role, which at times could necessitate taking enforcement action that could place the industry in a negative light. In fact, Sunset staff could find no other state agency that promotes a product that it also regulates. For example, the General Land Office (GLO) encourages the consumption of natural gas and the Texas Department of Agriculture (TDA) encourages Texans to buy products grown in the state, but neither GLO nor TDA regulate these products.
- **Duplicates other organization's promotion efforts.** Although the Commission once stood alone as the only entity that promoted propane in Texas, now other state and national organizations exist that serve the same purpose. The Propane Education and Research Council (PERC) promotes propane as an alternative fuel at the national level and the Propane Council of Texas (PRO-COT) promotes propane in Texas. Both PERC and PRO-COT perform many of the same functions as the Commission, including researching and developing innovative ways to use propane as an alternative fuel; advertising on public radio; providing financial incentives for fleet operators to purchase new propane vehicles; publishing brochures and magazines; and providing educational programs for homebuilders and fleet operators.

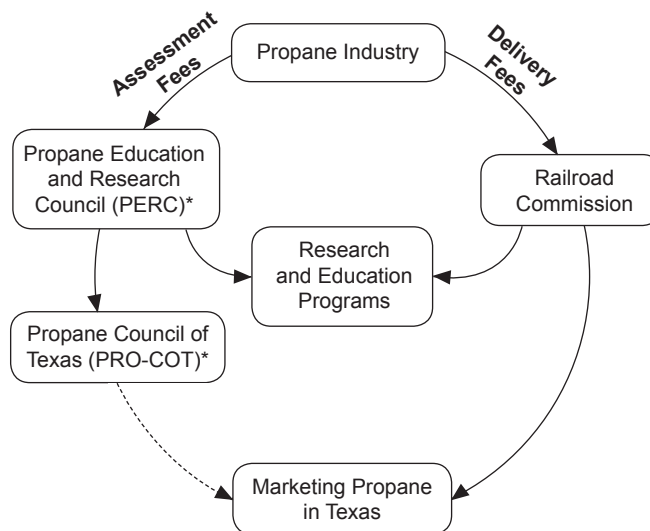
PERC and PRO-COT have recently shifted their focus from marketing propane to research and development and training because federal law restricts them from promoting propane if the price for propane exceeds the price for residential natural gas and electricity by more than 10.1 percent.⁴ Although these entities are currently restricted from promoting propane, programs still exist at both the national and state level that are able to promote propane should the price of natural gas and electricity increase. As a result, PERC and PRO-COT continue to provide a more appropriate mechanism for promoting propane, rather than the Commission who also serves as the regulator of the propane industry.

The propane industry, and ultimately the consumer, pays twice for the same function.

- **Duplicates fees.** The propane industry continues to pay a fee to the Commission to support its propane promotion function as well as a fee to PERC and PRO-COT to support similar programs. In 2012, the propane industry paid more than \$1.8 million in delivery fees to the Commission and an additional \$2 million in fees to PERC and PRO-COT to research

and promote propane in Texas. The flowchart, *Duplicative Funding for Propane Programs*, illustrates the industry's funding of research and promotion programs at both the national and state level. In the end, these extra costs to the industry impact the cost of propane to the customer.

Duplicative Funding for Propane Programs



* Limited to developing new propane technologies and providing safety training until the price index of propane falls below the price of residential natural gas and electricity.

Recommendation

Change in Statute

5.1 Eliminate the Commission's statutory authority to promote the use of propane and to charge a delivery fee for this purpose.

This recommendation would remove the Commission's statutory authority to promote propane and to assess a delivery fee on the propane industry for this program effective September 1, 2013. This recommendation would also eliminate the Commission's AFRED General Revenue dedicated account. The Commission would continue to administer, until completed, its current propane-related grants. In the future, nothing would prohibit the Commission from continuing to apply for such grants, provided that each grant covers the agency's associated administrative costs. This recommendation would not affect the Commission's propane-related licensing and regulatory staff, who are funded through separate licensing fees.

While the Propane Alternative Fuels Advisory Committee's statutory direction to advise the Commission on opportunities to expand the use of propane in Texas would expire, the Committee would continue to help the Commission develop ideas for training and testing of propane licensees. These changes would not impact the Commission's ongoing role in licensing businesses and individuals who work with propane.

Fiscal Implication

During the 82nd Session, the Legislature reduced the Commission's staff and appropriation to promote propane by more than 50 percent, from \$2.1 million in fiscal year 2011 to about \$931,000 in fiscal year 2012.⁵ To comply with existing statute, the Commission has continued to collect the same amount of fees. However, only half of the fee money collected was appropriated by the Legislature to support the Commission's propane rebate and promotion programs. The remainder of the fee money, which totals \$1,052,455, was deposited and retained in the AFRED General Revenue dedicated account.

This recommendation would eliminate expenditures for the Commission's propane rebate program and other propane promotion activities. The recommendation would also eliminate four full-time equivalent (FTE) positions at the Commission. However, these reductions are offset by an estimated annual revenue loss of \$1,052,455 to the AFRED General Revenue dedicated account, since current fee revenue greatly exceeds the actual costs of operating the program. Eliminating the Commission's propane promotion program and the AFRED General Revenue dedicated account would also likely result in funds remaining in the account from delivery fees being swept into the General Revenue Fund, causing a gain to General Revenue at the end of the current fiscal year.

Railroad Commission of Texas

Fiscal Year	Loss to the General Revenue Dedicated Account	Change in the Number of FTEs From FY 2013
2014	\$1,052,455	-4
2015	\$1,052,455	-4
2016	\$1,052,455	-4
2017	\$1,052,455	-4
2018	\$1,052,455	-4

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¹ Section 113.241, Texas Natural Resources Code.

² Section 113.2435, Texas Natural Resources Code.

³ Section 113.242, Texas Natural Resources Code.

⁴ 15 U.S.C. Chapter 6408.

⁵ H.B. 1, 82nd Texas Legislature, Regular Session, 2011.

ISSUE 6

Texas' Interstate Pipelines Lack Damage Prevention Oversight Needed to Ensure Public Protection.

Background

Texas has more than 214,000 miles of regulated pipelines transporting natural gas, oil and other hazardous liquids, and carbon dioxide. As described in the chart below, *Pipeline Regulation in Texas*, the Railroad Commission of Texas (Commission) oversees intrastate pipelines in Texas — pipelines that operate within the state's borders and typically link production sources to distribution systems. The federal Pipeline and Hazardous Materials Safety Administration (PHMSA) in the U.S. Department of Transportation oversees Texas' interstate pipelines that transport natural gas and other products to other states.

Pipeline Regulation in Texas

Regulatory Entity	Type of Pipeline	Description of Pipelines	Miles of Pipeline
Railroad Commission	Intrastate	Pipelines operating within Texas' borders	170,000
Federal PHMSA	Interstate	Pipelines that connect with pipelines in other states	44,000

To prevent damage to pipelines, the federal government created the 811 — Call Before You Dig — program, a national program that coordinates location services for underground utilities, including electric, telephone, cable, gas, sewer, and water lines. Excavators must call 811 before beginning a project to have all underground facilities marked at excavation sites.

The 811 program works in conjunction with the Commission's damage prevention program to prevent potential pipeline damage, including explosions caused by excavation near pipelines and pipeline facilities. The Commission can assess penalties against excavators and pipeline operators for failing to call 811 or for violations of its damage prevention rules, which set out best practices for excavators and pipeline operators. In fiscal year 2012, the Commission completed more than 3,800 enforcement actions against excavators and pipeline operators, collecting more than \$1.5 million in penalties. Nearly all reported incidents that were within the Commission's jurisdiction resulted in an enforcement action.

Finding

The Sunset Commission's recommendation to authorize the Railroad Commission to enforce damage prevention requirements for interstate pipelines continues to be appropriate.

Neither the federal government nor the Commission enforces damage prevention rules for interstate pipelines. The 2010 Sunset review found that Texas statute does not provide the Commission with any enforcement authority over interstate pipelines, preventing the Commission from enforcing damage

prevention rules for violations that affect these pipelines. While the federal government has oversight responsibility for interstate pipelines, no federal program exists to enforce damage prevention. In contrast, Texas has a fully operational system for enforcing damage prevention but only has authority under state law to oversee intrastate pipelines.¹ PHMSA continues to view damage prevention as a state issue that is best handled by a state's regulatory agency and encourages states to enforce damage prevention regulations for violations that affect interstate pipelines.²

Sunset staff found that incidents involving pipelines continue to pose a risk of serious damage to the pipeline system and fatalities. For these reasons, the Sunset Commission's proposed changes in law are still needed to respond to and deter damage to interstate pipelines and ensure public safety.

Recommendation

Change in Statute

6.1 Authorize the Commission to enforce damage prevention requirements for interstate pipelines.

This recommendation would authorize the Commission to amend its pipeline damage prevention rules to apply to interstate as well as intrastate pipelines, and to enforce these rules for violations that affect both types of pipelines. Under this recommendation, the Commission could assess administrative penalties against excavators and operators that violate damage prevention rules on interstate lines. The Commission would deposit these penalties in the General Revenue Fund, as it does with penalties from its intrastate pipeline damage prevention program.

Fiscal Implication

This recommendation would not result in a significant fiscal impact to the State. Commission staff could oversee damage prevention for interstate pipelines as part of its already established intrastate damage prevention program. Also, should workload expand beyond this capacity, the Commission would be eligible to apply for federal grants to cover additional costs.

As part of this expanded authority, the Commission would assess and collect administrative penalties, which would result in a gain to the General Revenue Fund. However, a fiscal impact could not be estimated at this time, as amounts generated would depend on the number and seriousness of future violations.

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¹ Section 117.012(a), Texas Natural Resources Code; Section 121.201(a), Texas Utilities Code; and Section 756.126, Texas Health and Safety Code.

² Pipeline Safety Improvement Act of 2002 (49 U.S.C. Section 60134).

ISSUE 7

The Commission's Mineral Pooling and Field Spacing Hearings Lack Certain Procedural Safeguards for Mineral Owners.

Background

The Mineral Interest Pooling Act allows the Railroad Commission of Texas (Commission) to pool mineral interests for a particular oil or gas well under certain circumstances.¹ Pooling is the gathering of several adjacent mineral owners' interests into a single unit for exploration and production purposes. Generally, when an operator does not have a lease agreement for all tracts for a particular oil or natural gas deposit, the operator can seek to have the Commission force those mineral owners without a lease into a single pooled unit for production to protect correlative rights and prevent waste.

Field spacing is another area where the Commission can authorize an operator, under certain circumstances, to drill a well over the objection of another mineral owner. The Commission sets the field spacing rules for wells in a given area, under Statewide Rule 37, limiting how close wells can be drilled near each other. If an operator needs to drill an oil or gas well closer than the standard spacing provided for by the Commission, the operator can apply for a Rule 37 exception to the field spacing rule if the operator can demonstrate that waste of the resource would occur without the exception.

Finding

The Sunset Commission's 2011 recommendations to ensure that the rights of mineral owners are protected during the forced pooling process continue to be appropriate.

The Commission's current process for informing mineral owners affected by an application for pooling uses outdated and highly technical language, resulting in potential confusion and a general lack of understanding of how to engage in contesting a permit. At the 2010 Sunset hearing, public testimony focused on how mineral owners seeking to protest a pooling application do not have the option of requesting a local hearing on the matter. In addition, witnesses testified that operators may withdraw their application at any time prior to the hearing, without penalty, adding further burden to mineral owners who may be forced to attend another hearing in Austin. While the Commission has experienced a decrease in applications for forced pooling in recent years due to reduced activity in the Barnett Shale, an increase in activity in either the Barnett Shale or Eagle Ford Shale regions could result in an increase in forced pooling applications, necessitating improvements to the Commission's current process.

In evaluating the continued appropriateness of the Commission's recommendations on forced pooling, Sunset staff found that some of the testimony provided during the Sunset hearing confused forced pooling hearings with hearings for Rule 37 exceptions to field spacing requirements.

Unexpected withdrawals of applications can unnecessarily burden mineral owners with repeated trips to Austin.

Public testimony on the practice of operators repeatedly withdrawing applications at the last minute until the protesting mineral owners failed to make it to a hearing was correct, but the practice has usually been in relation to applications for Rule 37 exceptions, not forced pooling. The Commission reports that with decreased activity in the Barnett Shale, the agency is not seeing operators withdraw their applications for field spacing exceptions as frequently. However, an increase in activity in either the Barnett Shale or Eagle Ford Shale regions could result in an increase in refilings, requiring the Commission to take action to curtail this practice.

Recommendations

Change in Statute

7.1 Authorize a party affected by forced pooling to request a hearing on the matter in the county where the proposed well will be drilled.

This recommendation would authorize a mineral owner or other party affected by forced pooling to request a local hearing, instead of having to attend a hearing at the Commission's central office in Austin. The recommendation would also authorize the Commission to hold such hearings by telephone if both parties agree.

Management Action

7.2 Direct the Commission to develop a fee schedule for increased charges associated with re-filing previously withdrawn applications for forced pooling or field spacing exceptions.

This recommendation would direct the Commission to develop an increased fee for those applicants who re-file applications for forced pooling or field spacing exceptions, when they have previously submitted and withdrawn an application set for hearing without giving proper notice. As part of this recommendation, the Commission would develop the timeframe as well as the fee associated with re-filing an application under these circumstances.

Fiscal Implication

Requiring the Commission to provide a local hearing for mineral owners seeking to protest applications for pooling would not result in a fiscal impact to the State, as the recommendation would authorize the Commission to conduct such hearings via telephone. The recommendation directing the Commission to charge a fee for re-filing applications that have been previously withdrawn should result in increased revenue to the Commission's Oil and Gas Regulation Cleanup Fund; however, the amount of revenue could not be estimated, as it would depend upon the number of applications withdrawn in the future.

¹ Chapter 102, Texas Natural Resources Code.

ISSUE 8

The Railroad Commission's Key Reporting Requirement Continues to Serve a Useful Purpose.

Background

Over the years, Sunset reviews have come to encompass an increasing number of standard elements either from direction traditionally provided by the Sunset Commission, or from statutory requirements added by the Legislature to the Criteria for Review in the Sunset Act, or from general law provisions typically imposed on state agencies. The following material summarizes Sunset staff's analysis of applicable standard elements for the Railroad Commission of Texas (Commission).

- **Reporting requirements.** The Sunset Act establishes a process for state agencies to provide information to the Sunset Commission about reporting requirements imposed on them by law and requires the Commission, in conducting reviews of state agencies, to consider if each reporting requirement needs to be continued or abolished.¹ The Sunset Commission has interpreted these provisions as applying to reports that are specific to the agency and not general reporting requirements that extend well beyond the scope of the agency under review. Reports required by rider to the General Appropriations Act are included as a matter of law, but under a presumption that the appropriations committees have vetted these requirements each biennium. Reporting requirements with deadlines or that have expiration dates are not included, nor are routine notifications or notices, posting requirements, or federally mandated reports.
- **Equal Employment Opportunities and Historically Underutilized Businesses.** The Sunset Act requires the Sunset Commission and its staff to consider agencies' compliance with applicable federal and state requirements regarding equal employment opportunities (EEOs) and historically underutilized businesses (HUBs).² Staff routinely evaluates agency performance regarding these requirements in the course of a Sunset review, but only reports deficiencies significant enough to merit attention.

Findings

The Commission's reporting requirement on the Oil and Gas Regulation and Cleanup Fund continues to serve a useful purpose.

State law requires the Commission to produce four reports that are specific to the agency and meet the parameters described above. Three of these reporting requirements include information relating to the amount of money deposited and spent from the Oil and Gas Regulation and Cleanup Fund (Fund); the balance of the Fund; and the Commission's use of money in the Fund related to oil and gas activities, which includes permitting, monitoring, inspecting, and well plugging. Because these three reporting requirements include similar information, the Commission produces one report that includes all statutorily required information. The Commission's other report requires the

Oil Field Cleanup Fund Advisory Committee to provide State leadership information about the progress of well plugging and site remediation for abandoned oil and gas wells. Sunset staff recommends abolishing this reporting requirement in Issue 2 of this report. Appendix B lists all four of the Commission's reporting requirements and Sunset staff's analysis of their need.

The Commission has not met EEO statewide civilian workforce percentages in certain categories for the last three years.

The 2010 Sunset review found that the Commission fell below statewide civilian workforce percentages for most job categories. Since that time, the Commission has made numerous improvements to its workforce percentages. However, the Commission continues to fall below EEO percentages for most categories, with the most significant disparity for females in the technical category. The Commission indicates it was unable to meet these percentages because the pool of applicants for open positions was predominately male, as is reflective of the greater workforce pool in the oil and gas industry. Appendix C shows the Commission's EEO performance in each job category for fiscal years 2009 to 2011.

The Commission has not met the State's HUB purchasing goals in certain categories for the last three years.

While the Commission has met HUB program requirements, such as appointing a HUB coordinator and establishing a HUB policy, the Commission has had difficulties meeting some statewide purchasing goals. From fiscal year 2009 to fiscal year 2011, the Commission fell significantly below HUB goals for the special trade and other services categories. The Commission states that many of its purchases in the other services category, which accounts for about 83 percent of the agency's expenditures, are limited to certain entities, making it difficult to meet goals. For example, purchases include items such as well plugging, site remediation, and surface mining reclamation contracts. Appendix D details the Commission's HUB spending for fiscal years 2009 to 2011 in all purchasing categories.

Recommendation

Change in Statute

8.1 Continue requiring the Commission to submit its report on the Oil and Gas Regulation and Cleanup Fund to the Legislature.

This recommendation would continue the Commission's report on the Oil and Gas Regulation and Cleanup Fund. To comply with a recent change in law, the Commission's report on the Oil and Gas Regulation and Cleanup Fund should be provided to the Legislature in an electronic format only. However, the Oil Field Cleanup Fund Advisory Committee's report would be abolished, as described in Issue 2.

Fiscal Implication

This recommendation would not have a fiscal impact to the State.

¹ Sections 325.0075, 325.011(13), and 325.012(a)(4), Texas Government Code.

² Section 325.011(9), Texas Government Code.

APPENDICES

APPENDIX A

Status of 2011 Sunset Commission Recommendations to the 82nd Legislature on the Railroad Commission of Texas

2011 Recommendation ¹	Status
Issue 1 – The 19th Century Design of the Three-Member, Elected Railroad Commission No Longer Aligns With the Agency’s Current-Day Mission.	
Change in Statute	
1.1 Establish the Texas Oil and Gas Commission, governed by a single, elected Commissioner, to assume the regulatory role currently served by the Railroad Commission, and continue the agency for 12 years. Require the Commission to develop a plan that encourages alternative dispute resolution and negotiated rulemaking procedures and applies them to its rulemaking, internal employee grievances, and other appropriate potential conflict areas.	Not Implemented – These recommendations require a change in statute. The 82nd Legislature continued the Railroad Commission of Texas (Commission) for two years in separate legislation, Senate Bill 652. This bill provided for the Sunset Commission to reexamine the agency in full and make recommendations to the 83rd Legislature regarding its continuance and functions. See Issue 1 of this report.
1.2 Prohibit the Texas Oil and Gas Commissioner and candidates seeking this office from receiving campaign contributions during certain timeframes.	
Issue 2 – Using General Revenue to Regulate the Oil and Gas Industry Shifts Oversight Costs From the Industry to Taxpayers.	
Change in Statute	
2.1 Require the Commission’s Oil and Gas program to be self-supporting, and authorize the Commission to levy surcharges on the program’s permits, licenses, certificates, or reports to achieve this purpose.	Implemented – The 82nd Legislature adopted this recommendation as part of S.B. 1, 1st Called Session. In response to this statutory change, the Commission now levies surcharges to support its Oil and Gas program. The Legislature also capped surcharges at 185 percent of fees. See Issue 2 of this report for related recommendations.
Change in Appropriations	
2.2 Add language in the General Appropriations Act to further ensure that the Commission collects fee amounts to offset the direct and indirect costs of administering its Oil and Gas program, including benefits.	Implemented – The 82nd Legislature adopted this recommendation as part of S.B. 2, 1st Called Session. In response to this change in appropriations, the Legislature reduced the general revenue funds that the Commission received and offset this loss with increases in fees and surcharges for the 2012-2013 biennium. See Issue 2 of this report for related recommendations.

Appendix A

2011 Recommendation ¹	Status
Change in Statute	
2.3 Reconstitute the Oil Field Cleanup Fund as the Oil and Gas Regulation and Cleanup Fund, continued as a dedicated fund in General Revenue established to pay for the entire Oil and Gas program.	Implemented – The 82nd Legislature adopted these recommendations as part of S.B. 1, 1st Called Session. These recommendations reconstitute the Oil Field Cleanup Fund as the Oil and Gas Regulation and Cleanup Fund and redirects fines previously deposited in the Oil Field Cleanup Fund to General Revenue. See Issue 2 of this report for related recommendations.
2.4 Redirect fines previously deposited in the Oil Field Cleanup Fund to General Revenue.	
2.5 Abolish the Oil Field Cleanup Fund Advisory Committee, but require the Commission to continue tracking related performance measures.	Not Implemented – This recommendation requires a change in statute. See Issue 2 of this report.
Issue 3 – Current Enforcement Processes Hinder the Commission’s Ability to Prevent Future Threats to the Environment and Public Safety.	
Change in Statute	
3.1 Require the Commission to develop, in rule, an enforcement policy to guide staff in evaluating and ranking oil- and natural gas-related violations.	In Progress / Statutory Change Still Needed –Although these recommendations have not yet been adopted in statute, the Commission has developed, in rule, a penalty matrix that ranks oil and gas violations and guides staff in evaluating violations. The Commission is also in the process of developing an enforcement policy in rule. See Issue 4 of this report.
3.2 Require the Commission to formally adopt penalty guidelines in rule.	
3.3 Transfer the Commission’s enforcement hearings to the State Office of Administrative Hearings.	Not Implemented – This recommendation requires a change in statute. See Issue 1 of this report.
Management Action	
3.4 Direct the Commission to revamp its tracking of violations and related enforcement actions tied to oil and natural gas production, and to develop a clear and consistent method for analyzing violation data and trends.	Implemented – In response to these recommendations, the Commission now tracks oil- and natural gas-related violations and enforcement actions. The Commission also publishes complaints and enforcement data on its website.
3.5 The Commission should publish additional complaint and enforcement data on its website.	
Issue 4 – The Commission’s Marketing of Propane Is No Longer Necessary.	
Change in Statute	
4.1 Eliminate the Commission’s authority to promote the use of propane.	Not Implemented – This recommendation requires a change in statute. See Issue 5 of this report.
Issue 5 – Texas’ Interstate Pipelines Lack Needed Damage Prevention Oversight to Ensure Public Protection.	
Change in Statute	
5.1 Authorize the Commission to enforce damage prevention requirements for interstate pipelines.	Not Implemented – This recommendation requires a change in statute. See Issue 6 of this report.

Appendix A

2011 Recommendation ¹	Status
Issue 6 – Impending Retirements of Key Staff Could Leave the Commission Vulnerable to a Significant Loss of Institutional Knowledge.	
Management Action	
6.1 The Railroad Commission should develop and implement a succession plan to prepare for impending retirements and workforce changes.	Implemented – The Commission has adopted a succession plan that identifies positions at risk of becoming vacant, the skills needed to fill vacancies, and experienced staff to fill vacancies. In addition, the Commission has started to prepare staff to assume top-level management roles by providing more training and development opportunities.
Issue 7 – Gas Utility Rate Cases Lack the Independent Review Provided to Other Utility Cases.²	
Change in Statute	
7.1 Require the Commission to use the State Office of Administrative Hearings to conduct hearings in contested gas utility cases.	Not Implemented – This recommendation requires a change in statute. See Issue 1 of this report.
Issue 8 – The Commission’s Oversight of Mineral Pooling Needs Clarification to Ensure Mineral Owners Are Aware of Their Rights.³	
Change in Statute	
8.1 Authorize a party affected by forced pooling to request a hearing on the matter in the county where the proposed well will be drilled.	Not Implemented – This recommendation requires a change in statute. See Issue 7 of this report.
8.2 Authorize the Commission to develop a fee schedule, by rule, for increased charges associated with re-filing permits that have been previously withdrawn.	Not Implemented – This recommendation can be achieved through a management action. See Issue 7 of this report.
Management Action	
8.3 Direct the agency to revise its notice of hearing provided to parties affected by forced pooling.	Implemented – The Commission now requires oil and natural gas operators to submit a map with its notice of hearing showing the location of the proposed well and potentially affected properties.

¹ The recommendations in this column were adopted by the Sunset Commission in January 2011 and are summarized in the Railroad Commission section of the Sunset Commission’s *Report to the 82nd Legislature*, which was published in February 2011 (pages 127-137). The original staff report, updated to show the status of each recommendation through the 82nd Legislature, is entitled *Sunset Advisory Commission Final Report on the Railroad Commission of Texas*, (July 2011). Both reports can be found on the Sunset Commission’s website.

² This issue was originally included in a *Supplement to the Sunset Staff Report on the Public Utility Commission*, November 2010, labeled S1.3.

³ This issue was added based on testimony at the December 2010 Sunset Commission hearing on the Railroad Commission. For additional information, see the Sunset Commission’s *Report to the 82nd Legislature*, February 2011.

APPENDIX B

Railroad Commission of Texas Reporting Requirements

Report Title	Legal Authority	Description	Recipient	Sunset Evaluation
1. Performance Goals for the Oil and Gas Regulation and Cleanup Fund, Report on	Section 81.069(b), Texas Natural Resources Code	Requires the Railroad Commission (Commission) to report the amount of money deposited into and spent from the Oil and Gas Regulation and Cleanup Fund (Fund), the balance of the Fund, and information about the Commission's progress in meeting performance goals for the Fund.	Legislative Budget Board	Continue
2. Oil Field Cleanup Activities, Report on	Section 81.069(c), Texas Natural Resources Code	Requires the Commission to report its performance goals for the Fund; number of orphaned wells plugged with state-managed funds; number of orphaned wells; number of inactive wells not currently in compliance with Commission rules; status of enforcement proceedings for all wells in violation of rules and the time in which the wells have been in violation; expenditures related to oil field cleanup activities; method by which the Commission sets priorities to determine the order to plug orphaned wells; projected amount of money needed to plug orphaned wells; and number of sites successfully remediated under the voluntary cleanup program.	Legislature	Continue
3. Oil and Gas Regulation and Cleanup Fund, Report on	Section 91.1135(e), Texas Natural Resources Code	Requires the Commission to report the amount of money deposited into and spent from the Fund; balance of the fund; number of wells plugged with money from the fund; number of sites remediated with money from the fund; and number of wells abandoned.	Legislative Budget Board and the Oil Field Cleanup Fund Advisory Committee	Continue
4. Oil Field Cleanup Fund Advisory Committee, Report on	Section 91.1135(g), Texas Natural Resources Code	Requires the Oil Field Cleanup Fund Advisory Committee to provide an analysis of any problems with the administration of the Fund, and recommend legislation needed to address problems identified with the administration of the fund.	Governor, Lieutenant Governor, and the Speaker of the House of Representatives	Abolish

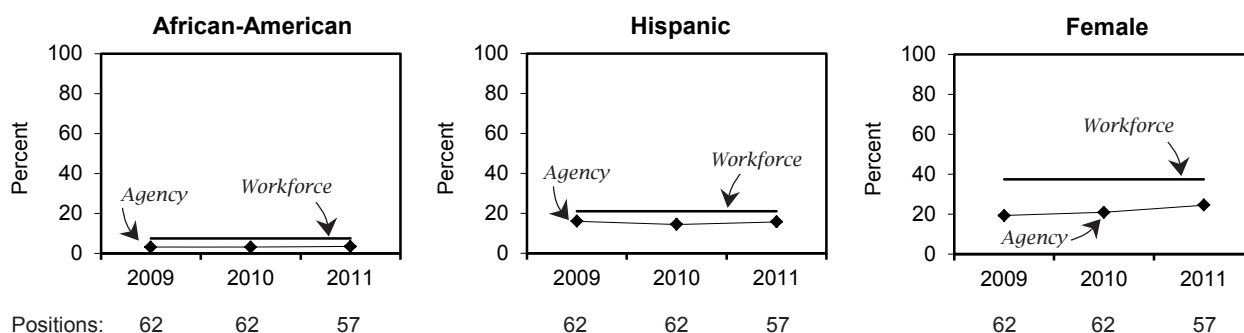
APPENDIX C

Equal Employment Opportunity Statistics 2009 to 2011

In accordance with the requirements of the Sunset Act, the following material shows trend information for the employment of minorities and females in all applicable categories by the Railroad Commission of Texas (Commission).¹ The Commission maintains and reports this information under guidelines established by the Texas Workforce Commission.² In the charts, the flat lines represent the percentages of the statewide civilian workforce for African-Americans, Hispanics, and females in each job category. These percentages provide a yardstick for measuring agencies' performance in employing persons in each of these groups. The diamond lines represent the Commission's actual employment percentages in each job category from 2009 to 2011.

The Commission has made improvements to its civilian workforce percentages for every category since the Commission last underwent Sunset review in 2010. However, the Commission continues to fall below statewide workforce percentages for most categories, with the most significant disparity for females in the technical category. The Commission attributes this failure to the fact that the pool of applicants for open positions are predominantly male, as is reflective of the greater workforce pool in the oil and gas industry.

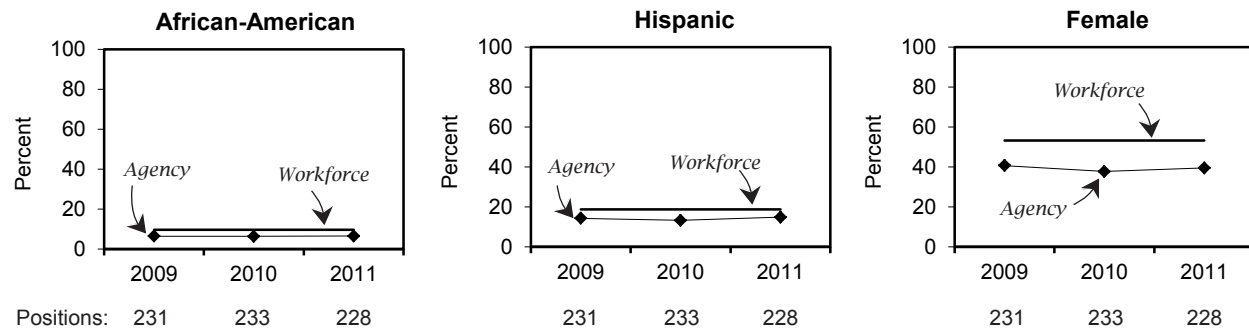
Administration



The Commission fell below the civilian workforce percentages in all three groups in the last three fiscal years.

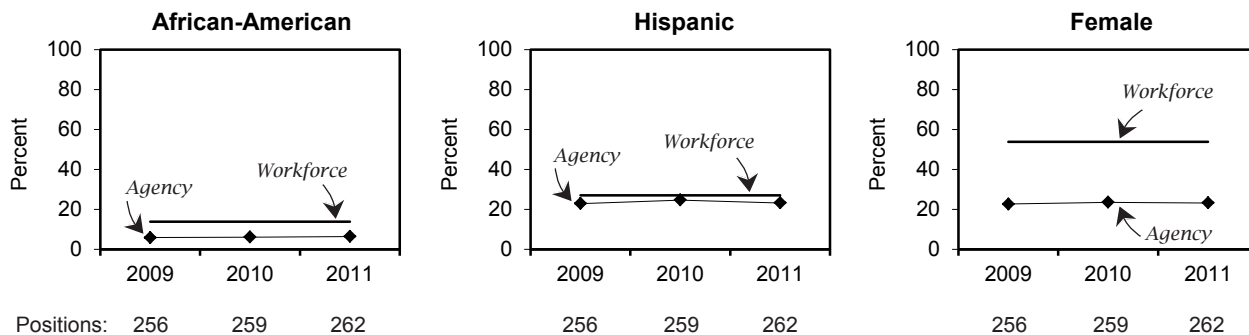
Appendix C

Professional



The Commission fell below the civilian workforce percentages in all three groups in the last three fiscal years.

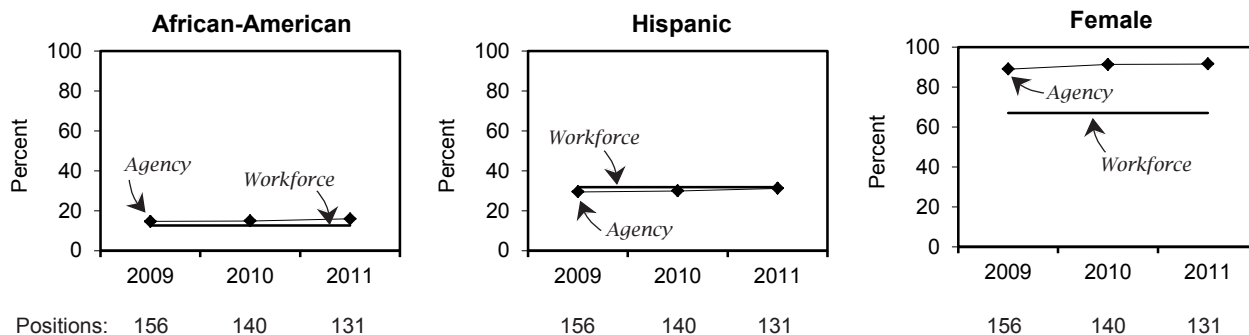
Technical



In the area of the agency with the most employees, the Commission fell below the statewide average for all three groups in each of the last three fiscal years, and most significantly fell below the average for females.

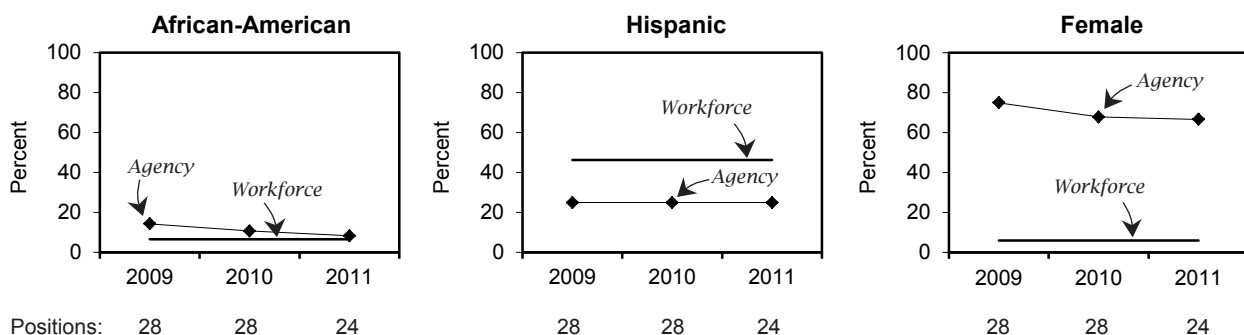
Appendix C

Administrative Support



With the exception of Hispanics in 2009 and 2010, the Commission met or exceeded the statewide average for all three groups in the last three fiscal years.

Skilled Craft



The Commission fell below the civilian workforce percentages for Hispanics in the last three fiscal years, while it exceeded averages for African-Americans and females.

¹ Section 325.011(9)(A), Texas Government Code.

² Section 21.501, Texas Labor Code.

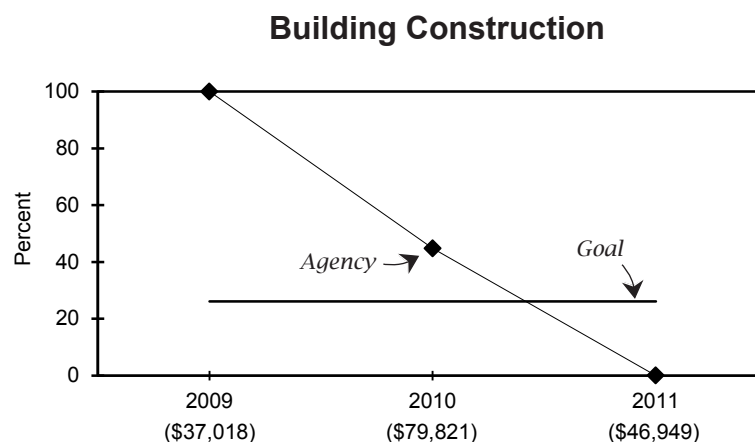
APPENDIX D

Historically Underutilized Businesses Statistics 2009 to 2011

The Legislature has encouraged state agencies to increase their use of Historically Underutilized Businesses (HUBs) to promote full and equal opportunities for all businesses in state procurement. The Legislature also requires the Sunset Commission to consider agencies' compliance with laws and rules regarding HUB use in its reviews.¹

The following material shows trend information for the Railroad Commission of Texas' (Commission) use of HUBs in purchasing goods and services. The Commission maintains and reports this information under guidelines in statute.² In the charts, the flat lines represent the goal for HUB purchasing in each category, as established by the Comptroller's Office. The diamond lines represent the percentage of Commission spending with HUBs in each purchasing category from 2009 to 2011. Finally, the number in parentheses under each year shows the total amount the Commission spent in each purchasing category.

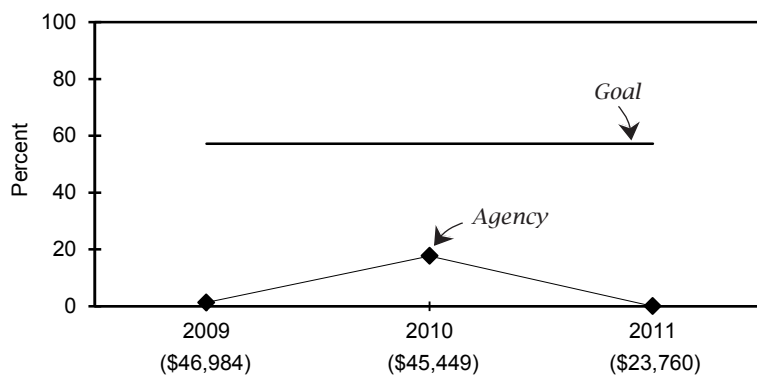
The Commission exceeded the State's HUB purchasing goals for the building construction, professional services, and commodities categories, but had difficulty meeting the goals for other purchasing categories. The Commission indicates that it has difficulty meeting HUB goals for the special trade and other services categories because many of its purchases are limited to certain entities that provide services such as well plugging and site remediation. The Commission has met other HUB-related requirements, such as appointing a HUB coordinator, establishing a HUB policy, and developing a mentor-protégé program.



In fiscal years 2009 and 2010, the Commission exceeded the State's goal for spending for building construction, but fell short of the goal in fiscal year 2011.

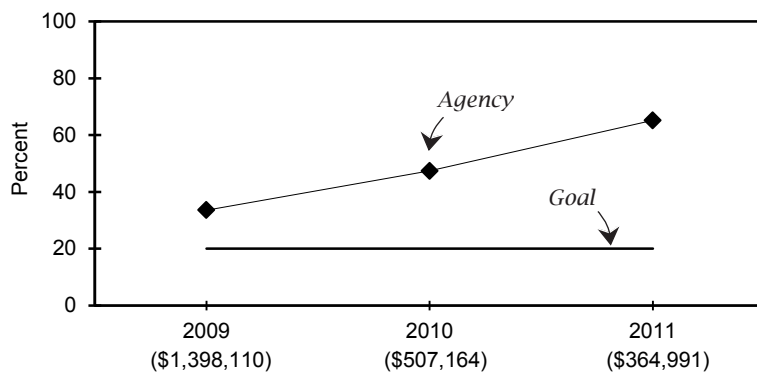
Appendix D

Special Trade



Purchases for this category fell significantly below the State's purchasing goal each fiscal year.

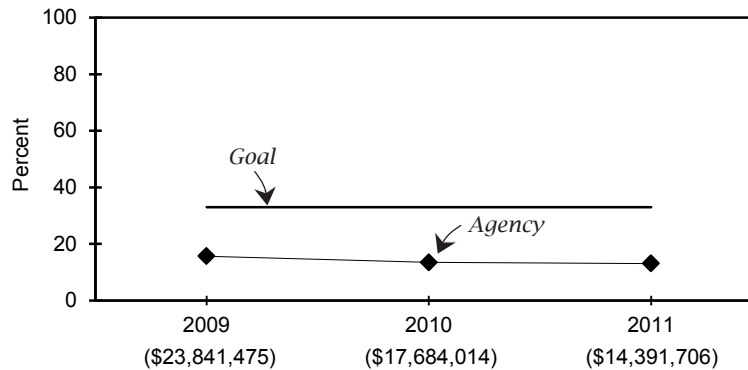
Professional Services



The Commission exceeded the State's goal for spending for professional services for each fiscal year.

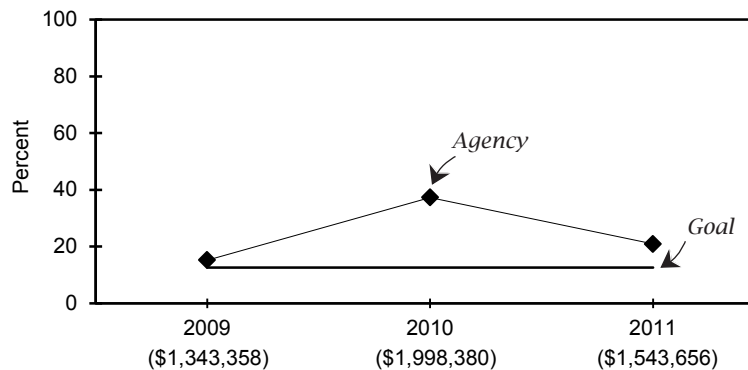
Appendix D

Other Services



In the category that accounts for the majority of the Commission's purchases, the Commission fell significantly below the State's purchasing goal each fiscal year.

Commodities



The Commission exceeded the State's goal for spending for commodities for each fiscal year.

¹ Section 325.011(9)(B), Texas Government Code.

² Chapter 2161, Texas Government Code.

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